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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

In re MOSES N. ASLAN,
Debtor.

MOSES N. ASLAN,
Petitioner,
vs.
THE HONGKONG AND SHANGHAI BANKING CORPORATION AND CENTRAL BANK,
Respondents.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1) Did the Ninth Circuit Court of Appeals err in affirming the Bankruptcy Court's failure to look behind a stipulated state court judgment to determine the validity of a creditor's claim against the bankruptcy estate?

2) Did the Bankruptcy Court err in failing to disallow the $2 million penalty portion of a creditor's claim?

PARTIES TO THE PROCEEDING

Petitioner and Respondents are named in the caption and were also parties before the Ninth Circuit Court of Appeals.

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No. _____

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1992

In re Moses N. Aslan,
Debtor.

MOSES N. ASLAN,
Petitioner,

vs.

THE HONGKONG AND SHANGHAI BANKING CORPORATION
and CENTRAL BANK,
Respondents.

PETITION FOR WRIT OF CERTIORARI

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Moses N. Aslan respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above-entitled case on May 29, 1992.

REPORTS OF OPINIONS BELOW

The Memorandum Opinion of the Ninth Circuit Court of Appeals filed May 29, 1992 (the "May 29th Opinion")[1] was not published. A copy of the May 29th Opinion is attached hereto as Appendix B. The Ninth Circuit Court of Appeals denied Petitioner's petition for rehearing and Respondent's suggestion for rehearing en banc by virtue of its Order filed July 28, 1992, a copy of which is attached hereto as Appendix A.

The May 29th Opinion reversed the earlier decision of the Ninth Circuit Court of Appeals filed March 25, 1991, which had unanimously reversed the decision of the United States District Court for the Central District of California entered May 3, 1989. A copy of the Ninth Circuit's March 25, 1991, Memorandum decision is attached hereto as Appendix C. The District Court had affirmed the decision of the United States Bankruptcy Court for the Central District of California entered January 5, 1988. The District Court did not write an opinion. A copy of the District Court's Order is attached hereto as Appendix D. The Bankruptcy Court's Findings of Fact and Conclusions of Law are attached hereto as Appendix E, and the Bankruptcy Court's Order is attached hereto as Appendix F.

STATEMENT OF JURISDICTION

This Court has jurisdiction pursuant to 28 U.S.C. §1254(1) to review the final decision of the Ninth Circuit Court of Appeals.

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[1] The May 29th Opinion was issued upon rehearing and replaced the Memorandum Opinion of the Ninth Circuit Court of Appeals filed March 25, 1991, a copy of which is attached hereto as Appendix B.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

A. United States Constitution, Article I, Section 8, Clause 4:

The Congress shall have power . . .

To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States.

B. 11 U.S.C. §105. Power of court.

The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

C. 11 U.S.C. §502. Allowance of claims or interests.

(a) A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects.

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

(1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured; . . . .

STATEMENT OF THE CASE

A. Factual Background.

The Hongkong and Shanghai Banking Corporation and Central Bank (the "Respondents" or the "Banks") are the holders of a claim against Moses N. Aslan (the "Petitioner" or the "Debtor") based on allegations made in a complaint filed by the Banks on or about December 2, 1983, which alleged numerous causes of action against several defendants, including the Debtor. The thrust of the allegations was directed to an alleged check kiting scheme. The complaint further alleged actual damages in the principal sum of $3,151,158.22, plus interest.

At the time, the Debtor owned several parcels of real property in the City of Los Angeles having an aggregate value in the millions of dollars (the "Parcels"). Having alleged a cause of action in the complaint for imposition of a constructive trust against the Parcels, the Banks recorded lis pendens upon all of the Parcels. In addition, with respect to at least one of the Parcels, commonly known as the Rowan Building, located in downtown Los Angeles, the Banks also held a promissory note secured by a first deed of trust and had commenced foreclosure proceedings in or around December 1984.

As a result of the lis pendens and the pending foreclosure proceedings, the Debtor was under extreme financial pressure to resolve his dispute with the Banks. Indeed, the lis pendens upon the Parcels made it virtually impossible for him to remedy his financial affairs without first satisfying the Banks. Accordingly, the Debtor was forced to enter into settlement negotiations with the Banks.

On or about March 25, 1985—the morning of the pending foreclosure sale of the Rowan Building—the parties and their counsel met on the steps of the Los Angeles Superior Court in Norwalk, California, in a final effort to settle their litigation. The Debtor and the Banks reached an agreement that day, and that agreement was subsequently memorialized in the Stipulated Judgment.

The Stipulated Judgment provided for entry of a judgment in the sum of $8,373,298.50, plus interest, but also provided that if the Debtor paid certain installment payments timely, which payments totaled $6,363,298.56, the Banks would provide the Debtor with an executed Satisfaction of Judgment.[2]

The Stipulated Judgment called for installment payments to be made by the Debtor totaling the aforesaid $6,373,298.56 as follows:

(1) $1,584,574.64 on July 1, 1985;
(2) $1,584,574.64 on September 30, 1985;
(3) $1,619,574.64 on December 31, 1985;
(4) The remaining unpaid balance plus interest on June 30, 1986.

The Stipulated Judgment did not specifically

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[2] It should be noted that the Stipulated Judgment contains no admission by the Debtor of liability for any alleged wrongdoing. Indeed, the entire record below is totally silent on this point. The Banks have taken every opportunity in the courts below to denigrate the Debtor's character and cast him in as bad a light as possible. However, neither the Stipulated Judgment nor the Bankruptcy Court's Findings of Fact contain any support whatsoever for such allegations. The Debtor's motivation for agreeing to the terms of the Stipulated Judgment is clear. By recording lis pendens and threatening foreclosure, the Banks had so tied up the Debtor's property that he had no choice but to agree to the Stipulated Judgment or face the loss of *all* his real estate holdings.

characterize the component sums of the Stipulated Judgment. The Debtor asserted that the difference between the Stipulated Judgment sum and the sum which would satisfy the Stipulated Judgment if paid timely, $2 million, was intended to be a penalty to be assessed against the Debtor if he failed to meet his obligations under the Stipulated Judgment. This conclusion is supported by various statements made by the Bank's counsel which were reflected in the record below.

On or about June 11, 1985, after continuing the foreclosure sale from time to time, the Banks foreclosed upon the Rowan Building, and were the successful bidders at the foreclosure sale, credit bidding the sum of $1,694,010.66, the amount due under the Banks' note and deed of trust thereon. A few weeks later, in July 1985, the Banks sold the Rowan Building to the Rowan Development Corporation (a buyer found by the Debtor) for $5 million.

Shortly thereafter, the Debtor and the Banks entered into a Letter Agreement dated August 1, 1985, pursuant to which the Banks agreed to, and did, credit the net proceeds of the Rowan Building sale to the full and complete payment of the July 1, 1985, and September 30, 1985, installment payments (each in the sum of $1,584,574.64) as required under the Stipulated Judgment.

At that point, a third party, the Amana Corporation, began negotiating with the Banks to purchase the Stipulated Judgment, which would have relieved Debtor from his liability to the Banks, including exposure on the $2 million penalty. At all times, the representative of the Amana Corporation made it clear to the Banks that, in purchasing the Stipulated Judgment, the Amana Corporation was effectively paying it off *current* and, therefore, the $2 million penalty could not be triggered and would not be a part of the purchase price.

On December 30, 1985, the Amana Corporation

submitted a letter (the "Letter of Intent") to the Banks in which the Amana Corporation offered to purchase the Stipulated Judgment for $3,536,110.90, an amount which did not include payment of the $2 million penalty. It was clearly understood by all the parties that the Amana Corporation's offer was to purchase the Stipulated Judgment without payment of the $2 million penalty.

The Banks responded to the Letter of Intent offer in the form of a counteroffer. The original purchase price proposed by the Amana Corporation of $3,536,110.90 in the Letter of Intent, which *did not include any penalty provision*, was retained in the Banks' counterproposal. The Banks' counteroffer was thereafter rejected by Amana Corporation, not because of the price, but because the Banks added certain indemnification provisions which were unacceptable to the Amana Corporation.

During the period from December 30, 1985, until February 28, 1986, negotiations continued between the Amana Corporation and the Banks toward a mutually acceptable purchase of the Stipulated Judgment. Eventually the negotiations broke down and the Debtor, at that point, had no choice but to file his Chapter 11 petition. The Chapter 11 case was commenced on March 3, 1986.

B. Procedural Background.

A Chapter 11 Trustee was appointed on June 23, 1986.

The Banks filed their Amended Proof of Claim (Secured) (the "Claim") on or about July 28, 1986.

The Debtor filed his objection to the Claim on November 24, 1986. The objection was originally scheduled to be heard on January 22, 1987, but was continued from time to time until August 13, 1987.

At the August 13, 1987, hearing, the Bankruptcy Court declined to inquire into the basis for the Stipulated Judgment to determine whether the $2 million provision

constituted an unenforceable penalty under either California or bankruptcy law. The Court considered the Stipulated Judgment final, binding, and nonreviewable.

At the continued hearing on September 2, 1987, the Bankruptcy Court allowed the Banks' Claim in the full amount of the Stipulated Judgment, plus accrued interest, totaling in excess of $8.3 million. The Bankruptcy Court reasoned that the Stipulated Judgment was so structured that the $2 million provision constituted an "option" whereby if the Debtor timely performed, the $2 million provision could be avoided. The Bankruptcy Court ruled that, under bankruptcy law, the time to exercise the "option" (make the fourth payment) expired on July 1, 1986, pursuant to 11 U.S.C. §108(b). The Bankruptcy Court found that since the Debtor had not made the fourth payment before that date (due to the ongoing negotiations between the Banks and the Amana Corporation), the Debtor had defaulted, the option had expired, and the entire amount of the Stipulated Judgment was due.

The Chapter 11 Trustee has paid to the Banks the full amount of their Claim as allowed by the Bankruptcy Court. The Banks have therefore been paid the $2 million plus interest at issue here.

After the hearing on the Debtor's objection to the Claim, both the Debtor and the Banks lodged proposed findings of fact and conclusions of law. Due to the internal inconsistencies in each and the Debtor's objection to the Banks' proposed findings, the Bankruptcy Court's order allowing the Banks' Claim was not entered until January 5, 1988. On January 22, 1988, the Debtor filed his motion for reconsideration of the Bankruptcy Court's order allowing the Banks' Claim and to amend the conclusions of law. The motion for reconsideration was withdrawn by the Debtor prior to the time set for hearing thereon. The Bankruptcy Judge's conclusions of law were amended, but not in a manner relevant to this appeal.

The Debtor thereafter timely filed his notice of appeal to the Bankruptcy Appellate Panel of the Ninth Circuit. The Banks cross-appealed on an issue involving the proper allocation of an offset. The offset issue is not a part of this appeal.

The Banks objected to the appeals being heard and decided by the Bankruptcy Appellate Panel of the Ninth Circuit, and the appeals were referred to the United States District Court for the Central District of California.

After briefing by the parties, the District Court, by Judge Edward Rafeedie, affirmed the Bankruptcy Court on both the Debtor's appeal and the Banks' cross-appeal. The Debtor thereupon filed his notice of appeal to the United States Court of Appeals for the Ninth Circuit and the Banks' notice of appeal followed.

The Ninth Circuit originally entered a Memorandum Opinion filed March 25, 1991, reversing the Bankruptcy Court's decision with regard to the $2 million penalty and affirming the Bankruptcy Court's decision with regard to the offset. The Banks requested a rehearing. On rehearing, the Ninth Circuit issued a second Memorandum Opinion filed May 29, 1992, which affirmed the Bankruptcy Court on both issues. The Debtor requested a rehearing and the Banks filed a suggestion for rehearing en banc. Both rehearing requests were denied by Order of the Ninth Circuit Court of Appeals on May 29, 1992.

C. Basis of Jurisdiction in the Bankruptcy Court.

The basis for federal jurisdiction of this case in the United States Bankruptcy Court is pursuant to 28 U.S.C. §1334(a) and 28 U.S.C. §157(b). The issue of the allowance of the Banks' Claim was a core proceeding under 28 U.S.C. §§157(b)(2)(B) and (C).

ARGUMENT

I.

REASONS FOR GRANTING THE WRIT

Petitioner's petition for writ of certiorari should be granted because the United States Court of Appeals for the Ninth Circuit has so sanctioned the Bankruptcy Court's departure from the accepted and usual course of judicial proceedings as to call for an exercise of the Supreme Court's power of supervision.

II.

THE BANKRUPTCY COURT'S MECHANICAL APPLICATION OF THE DOCTRINE OF RES JUDICATA AND 28 U.S.C §1738 TO A STIPULATED JUDGMENT RENDERED IN THE STATE COURT IGNORED THE EQUITABLE POWERS OF THE BANKRUPTCY COURT TO ACHIEVE THE GOALS OF THE FEDERAL BANKRUPTCY SCHEME.

The Bankruptcy Court erred by not following its mandate to fairly and equitably distribute the assets of the estate. Instead, it mechanically applied the doctrine of res judicata notwithstanding that the result unfairly affected other parties in interest.

The power of the bankruptcy court stems from Article I of the United States Constitution, which grants to Congress the power "to establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const., Art. I, §8, cl. 4. Bankruptcy law is a paramount law which takes precedence over all state laws and proceedings. *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed. 162 (1946); *Kalb v. Feuerstein*, 308 U.S. 433, 60 S.Ct. 343,

84 L.Ed. 370 (1940). Federal statutes govern the proof and allowance of claims based on judgments. "In determining which judgments are provable and what objections may be made to their proof . . . , the bankruptcy court is defining and applying federal, not state, law." *Heiser v. Woodruff*, 327 U.S. 726, 732, 66 S.Ct. 853, 90 L.Ed. 970 (1946), *reh'g denied*, 328 U.S. 879, 66 S.Ct. 1335, 90 L.Ed. 1647 (1946).

Section 105(a) of the Bankruptcy Code, 11 U.S.C. §§101 *et seq.* (1988) (hereinafter the "Bankruptcy Code"), provides that "the bankruptcy court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. §105(a) (1988). For most purposes, bankruptcy courts are "essentially courts of equity and their proceedings inherently proceedings in equity." *Pepper v. Litton*, 308 U.S. 295, 304, 60 S.Ct. 238, 84 L.Ed. 281 (1939) (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 240, 54 S.Ct. 695, 78 L.Ed. 1230 (1934)); *see also Continental Ill. Nat'l. Bank v. Chicago, Rock Island and Pac. Ry. Co.*, 294 U.S. 648, 55 S.Ct. 595, 79 L.Ed. 1110 (1935). A bankruptcy court may exercise its equity powers to do justice and prevent an inequitable result, such as to set aside a fraudulent claim, even where that claim has been reduced to judgment. *Heiser v. Woodruff*, 327 U.S. at 732; *Pepper v. Litton*, 308 U.S. at 305-06.

It is clear that a bankruptcy court is required to look behind a state court judgment in determining whether to allow a claim based on that judgment when the state court that issued the judgment lacked jurisdiction over the parties or the subject matter and when the judgment was obtained by collusion of the parties or by fraud. *See Pepper v. Litton*, 308 U.S. at 306; *Heiser v. Woodruff*, 327 U.S. at 736; *Margolis v. Nazareth Fair Grounds & Farmers Mkt., Inc.*, 249 F.2d 221, 224 (2d Cir. 1957); *Kelleran v.*

Andrijevic, 825 F.2d 692, 694 (2d Cir. 1987), *cert. denied*, 484 U.S. 1007, 108 S.Ct. 701, 98 L.Ed. 2d 652 (1988). Other courts have allowed a state court judgment to be attacked in the bankruptcy court where the judgment is a product of duress, *Fazio v. Alan Sinton, Ltd. (In re Fazio)*, 41 Bankr. 865 (Bankr. E.D. Pa. 1984), or where the judgment amount exceeded an express limitation imposed by the Bankruptcy Code, *In re Bus Stop, Inc.*, 3 Bankr. 26 (Bankr. S.D. Fla. 1980).

Petitioners argue that this list of exceptions is not exclusive. The bankruptcy court, as a court of equity, should be able to look behind a state court judgment whenever equity requires such a review. *See Kelleran v. Andrijevic*, 825 F.2d at 697-98 (Blumenfeld, J., dissenting).

As this Court stated in *Pepper v. Litton*, "[i]n the exercise of its equitable jurisdiction the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate." *Pepper v. Litton*, 308 U.S. at 307-08.

> [A] bankruptcy court has full power to inquire into the validity of any claim asserted against the estate and to disallow it if it is ascertained to be without lawful existence. And the mere fact that a claim has been reduced to judgment does not prevent such an inquiry.

Id. at 305 (citation omitted). A bankruptcy court's equitable powers "have been invoked to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done." *Id.*

This Court has clearly established that the doctrine of res judicata is not to be mechanically applied in the context of bankruptcy. A state court judgment should not have

automatic res judicata effect; only a bankruptcy judge can decide whether a claim is allowable, and the judge may look behind the claim to determine its validity. *See* 3 Collier on Bankruptcy ¶502.02, at 502-22-34 n. 8 (15th ed. 1980).

Where the doctrine of res judicata is applied, it is not based upon a technical application of the doctrine,

> but upon the court's recognition that the equitable considerations underlying that doctrine require its application in the *absence* of compelling circumstances to the contrary. To the extent that *equitable principles require reexamination* by the bankruptcy court of the bases for the judgment where these bases have been or could have been previously adjudicated, the doctrine of res judicata is *inapplicable* in bankruptcy proceedings.

Margolis v. Nazareth Fair Grounds & Farmers Mkt., Inc., 249 F. 2d, at 224 (emphasis added).

In the case at bar, the Bankruptcy Court erred by mechanically applying the doctrine of res judicata, despite the Debtor's assertion that a portion of the judgment was invalid under California law. The Bankruptcy Court refused to look behind the judgment to determine whether the Claim should have been partially disallowed as invalid, ruling that res judicata prevented the Court from considering the question.

III.

IN DETERMINING THE VALIDITY AND EXISTENCE OF CLAIMS, THE BANKRUPTCY COURT SHOULD APPLY STATE SUBSTANTIVE LAW; IN DETERMINING WHETHER A CLAIM SHOULD BE ALLOWED, THE BANKRUPTCY COURT SHOULD APPLY FEDERAL BANKRUPTCY LAW.

In the claims objection context, the bankruptcy court must engage in a two-part analysis. First, the bankruptcy court must consider whether the claim is valid, and this determination involves a review of the applicable law that forms the basis for the claim. "What claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition is filed is a question which, in the absence of overruling federal law, is to be determined by reference to state law." *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. at 161. *See also Grogan v. Garner*, ___ U.S. ___, 111 S.Ct. 654, 657, 112 L.Ed. 2d 755 (1991); *Southwest Bank v. Parsons (In re Parsons)*, 124 Bankr. 818 (Bankr. S.D. Cal. 1991). But state law is applied only in determining whether the creditor holds a valid claim, not whether and in what amount the claim should be allowed. *See In re Bowers*, 16 Bankr. 298 (Bankr. D. Conn. 1981).

After the bankruptcy court has determined whether the claim is valid, it then "must administer and enforce the Bankruptcy [Code] as interpreted by this Court in accordance with authority granted by Congress to determine how and what claims shall be allowed under equitable principles." *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. at 163. Thus, even if a claim is valid under state law, the bankruptcy court is required to

apply federal bankruptcy law and general equitable principles in determining whether the claim should be allowed and in what amount. *In re Spanish Trails Lanes, Inc.*, 16 Bankr. 304 (Bankr. D. Ariz. 1981).

The plain meaning of Section 502(b)(1) of the Bankruptcy Code makes this principle all the more obvious. The statute requires the bankruptcy court to determine the *amount* of each claim and to allow such claim in that amount *unless the claim is unenforceable under applicable law*. *See* 11 U.S.C. §502(b)(1) (1988). Thus, the bankruptcy court is under a statutory mandate to inquire into the validity of each claim to which an objection is made and to establish the allowed amount of that claim.

As was stated above, the bankruptcy court in the allowance of claims process should not be bound by any broad or rigid rule of res judicata. In particular, where the claim is based on a stipulated judgment, and not on any litigation of the merits of the claim, the judgment cannot be said to reflect any determination of the substantive rights of the parties. *See Margolis v. Nazareth Fair Grounds & Farmers Mkt., Inc.*, 249 F.2d at 221.

In *Margolis*, two claims were based on judgment notes issued by the debtor corporation which had been reduced to judgment in state court by confession. The debtor objected to the allowance of the creditors' claims. The bankruptcy referee disallowed the claims after determining that there was no legal basis for the claims and that the creditors, former directors of the debtor, had engaged in fraud in obtaining the judgments. *Id.* at 222-23. The creditors argued that the bankruptcy referee had no power to inquire into the validity of their claims since the claims had been reduced to judgment in the state court prior to the bankruptcy filing. *Id.* at 223. Relying on *Heiser v. Woodruff*, the creditors asserted that the doctrine of res judicata should have been applied by the referee and their

claims allowed. *Id.* at 224.

On appeal, the Second Circuit Court of Appeals affirmed the bankruptcy referee's disallowance of the claims. The Second Circuit Court noted that the claims in *Heiser v. Woodruff* had been fully litigated in the lower courts. In such a context, "failure to raise a defense when there was ample opportunity to do so . . . will also generally preclude the recognition of the defense in the bankruptcy court." *Id.* However, where the party is prevented from raising a defense or has had no opportunity to litigate the merits of the claim in another forum, there is no reason to bar that defense when it is asserted in the bankruptcy court. *Id.* at 224-25; *accord Spilman v. Harley*, 656 F.2d 224 (6th Cir. 1981) (where important issues not actually litigated in prior proceeding, collateral estoppel does not bar relitigation in bankruptcy court); *Hovermale v. Pigge (In re Pigge)*, 539 F.2d 369 (4th Cir. 1976) (only issues which have actually been litigated in state court are entitled to res judicata or collateral estoppel effect).

In the instant case, the Respondents' Claim is based on a Stipulated Judgment entered in state court after the Debtor defaulted on the payment of debt. Petitioner has asserted that a portion of the Claim should be disallowed because it is invalid under California law or bankruptcy law. The Bankruptcy Court did not look into the basis of the Stipulated Judgment to determine the validity of the Claim, instead mechanically applying res judicata.

Had the Bankruptcy Court looked behind the Stipulated Judgment, it would have discovered that the $2 million penalty portion of the Banks' Claim is unenforceable under either California or bankruptcy law. California law provides that stipulated judgments are regarded as contracts between the parties and must be construed as any other contract. *Milicevich v. Sacramento Medical Center*, 155

Cal. App. 3d 997, 1004 fn. 9, 202 Cal. Rptr. 484 (Cal. Ct. App. 1984); *Rappenecker v. Sea-Land Service, Inc.*, 93 Cal. App. 3d 256, 263, 155 Cal. Rptr. 516 (Cal. Ct. App. 1979); *Los Angeles City School District of Los Angeles County v. Landier Investment Co.*, 177 Cal. App. 2d 744, 750-51, 2 Cal. Rptr. 662 (Cal. Dist. Ct. App. 1960) (hereinafter *L.A. v. Landier*). It is well established that contractual provisions which violate state law are unenforceable. *See, e.g., Lewis & Queen v. N. M. Ball Sons*, 48 Cal. 2d 141, 308 P.2d 713 (Cal. 1957).

In California,

> liquidated damages not reasonably related to actual damages are unenforceable and void as penalties. An exception exists where damages cannot be readily ascertained [Cal. Civ. Code, . . . §1671 (West 1970)], but since damages for the withholding of money are easily determinable—i.e., interest at prevailing rates—penal provisions for mere delay in the payment of money are not ordinarily enforceable. [Cal. Civ. Code, §3302 (West 1970)]. Although provisions for liquidated damages for late payments can be characterized as provisions for alternative performance rather than penalties, . . . it is now clear that when such "late charges" bear no relation to actual damages for delay they are void.

Sybron Corp. v. Clark Hospital Supply Corp., 76 Cal. App. 3d 896, 900, 143 Cal Rptr. 306 (Cal. Ct. App. 1978) (citations omitted). *See also Garrett v. Coast & Southern Fed. Sav. & Loan Ass'n*, 9 Cal. 3d 731, 108 Cal. Rptr. 845, 511 P.2d 1197 (Cal. 1973); *L.A. v. Landier*, 177 Cal. App. 2d at 752-53. Whether the $2 million "late charge" in the Stipulated Judgment was unenforceable as a penalty under California law was a factual determination that the Bankruptcy Court should have made after holding a full

hearing on the merits to determine the substantive rights of the parties.

The Debtor also asserted that the $2 million at issue constituted an unenforceable penalty under bankruptcy law. As a court of equity, bankruptcy courts have not traditionally allowed the penalty portion of a creditor's claim. *See Black v. Strand (In re Black Ranches, Inc.)*, 362 F.2d 8, 15-16 (8th Cir. 1966) (quoting *In re Tastyeast, Inc.*, 126 F.2d 879, 881 (3d Cir. 1942), *cert. denied*, 316 U.S. 696, 62 S.Ct. 1291, 86 L.Ed. 1766 (1942)). Where a liquidated damages provision is clearly meant to be more than compensatory, the courts have typically characterized it as a penalty. In applying the principles of the Bankruptcy Code, courts frequently hold penalties to be unenforceable and disallow that portion of a creditor's claim. *See, e.g., In re Klefstad*, 95 Bankr. 622, 625 (Bankr. W.D. Wis. 1988); *In re Oahu Cabinets, Ltd.*, 12 Bankr. 160, 165 (Bankr. D. Haw. 1981).

The Bankruptcy Court erroneously stated that Petitioner should have raised the invalidity claim at the state court level, even though stipulated judgments are not generally entitled to appellate review. *See Thompson v. Maxwell Land Grant & Ry. Co.*, 168 U.S. 451, 18 S.Ct. 121, 42 L.Ed. 539 (1897) (cited with approval in *Newport v. Hatton*, 195 Cal. 132, 231 P. 987, 990 (Cal. 1924)). *See also Hibernia Sav. & Loan Soc'y v. Waymire*, 152 Cal. 286, 92 P. 645 (Cal. 1907); *Erlanger v. Southern Pac. Ry. Co.*, 109 Cal. 395, 42 P. 31 (Cal. 1895). Further, the Bankruptcy Court declined to hear evidence regarding the Petitioner's assertions that the Stipulated Judgment was obtained by Respondents under conditions of duress. Contracts entered into under economic duress can be set aside and any payments made recovered. *See, e.g., Rowland v. Watson*, 4 Cal. App. 476, 88 P. 495 (Cal. Dist. Ct. App. 1906). The Bankruptcy Court erred by not

making any inquiry into the grounds for the Claim, and the Ninth Circuit Court of Appeals should not have affirmed, and thus condoned, the Bankruptcy Court's misapplication of the law.

IV.

THE STATE'S INTEREST IN HAVING ITS COURTS' DETERMINATIONS RECOGNIZED MUST BE BALANCED AGAINST THE BANKRUPTCY COURT'S INTEREST IN REACHING A JUST AND EQUITABLE RESULT.

The principle underlying the doctrine of res judicata is "the generally recognized public policy that there must be some end to litigation and that when one appears in court to present his case, is fully heard, and the contested issue is decided against him, he may not later renew the litigation in another court." *Heiser v. Woodruff*, 327 U.S. at 733 (quoting *Baldwin v. Traveling Men's Assn.*, 283 U.S. 522, 525-26, 51 S.Ct. 517, 75 L.Ed. 1244 (1931). "Res judicata thus encourages reliance on judicial decisions, bars vexatious litigation, and frees the courts to resolve other disputes." *Brown v. Felsen*, 442 U.S. 127, 131, 99 S.Ct. 2205, 60 L.Ed. 2d 767 (1979).

The states clearly have an interest in having their courts' determinations recognized, and res judicata advances that interest. The bankruptcy courts should give due consideration to the states' interests, but only where the state court established the substantive rights of the parties after both sides had a full opportunity to be heard and the incentive to raise their various claims and defenses. *See id.*; *Spilman v. Harvey*, 656 F.2d at 224; *Hovermale v. Pigge (In re Pigge)*, 539 F.2d at 369; *Margolis v. Nazareth Fair Grounds & Farmers Mkt., Inc.*, 249 F.2d at 221; *Goldsmith v. Harck (In re Harck)*, 70 Bankr. 118 (9th Cir. 1987).

Thus, the bankruptcy court's analysis, when presented with an objection to a claim based on a judgment, must involve an inquiry into whether the judgment was based on actual litigation. The parties must have been afforded a full opportunity to be heard and the incentive to raise all claims and defenses upon which the claim in bankruptcy is made.

In the case at bar, the substantive rights of the Petitioner have never been established in a forum where he had a full opportunity to be heard and the incentive to raise his defenses to the Claim. The judgment upon which Respondents' Claim is based is a Stipulated Judgment. Petitioner entered into the stipulation before bankruptcy was filed, and the circumstances surrounding the stipulation show that Petitioner's goal at the time was to delay foreclosure of his properties. The Stipulated Judgment was not appealable. The issue of the validity of the $2 million penalty has never been litigated, Petitioner has not been afforded an opportunity to be heard, and until the claim was presented in the bankruptcy proceeding, Petitioner had no incentive to litigate its validity. It is worth noting that the penalty itself did not become part of Respondents' Claim until *after* the bankruptcy case was filed, because the final payment was not due at the time of the commencement of the case.

The bankruptcy court has an interest in ensuring that an estate is administered in such a way as to "bring about a ratable distribution of assets among the bankrupt's creditors." *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. at 161. The purposes of the Bankruptcy Code include successful rehabilitation of debtors and treating all creditors in a fair and equitable manner. *In re Spanish Trails Lanes, Inc.*, 16 Bankr. at 307. The possible injurious effect on other creditors is one of the aspects of equity that the bankruptcy may consider in the claims

allowance process. *In re Beck Rumbaugh Associates, Inc.*, 114 Bankr. 418, 421 (E.D. Pa. 1990), *aff'd*, 841 F.2d 1120 (3d Cir. 1988).

Equality of distribution among the creditors is one of the themes of the federal bankruptcy scheme. *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219, 61 S.Ct. 904, 85 L.Ed. 1293 (1941). Disallowance of penalties advances that theme. The bankruptcy court has the power to enforce and implement such equitable considerations under Section 105 of the Bankruptcy Code, which grants the court broad powers to carry out the bankruptcy statutes. 11 U.S.C. §105(a) (1988).

CONCLUSION

The interest of the state in having its court's judgments recognized and the interest of the bankruptcy court in equitably distributing the estate's assets must be balanced whenever the bankruptcy court is faced with a claim based upon a state court judgment. Mechanical application of res judicata, especially where the judgment was not the result of actual litigation on the merits, does not provide the appropriate balance. Instead, the Bankruptcy Court should have looked into the merits of the Claim presented by Respondents before deciding whether to allow the Claim. The Bankruptcy Judge failed to correctly apply the law, and the Ninth Circuit Court of Appeals has affirmed this erroneous decision.

For the foregoing reasons, the petition for a writ of certiorari should be granted so that Petitioner can present his defense to the $2 million penalty portion of Respondents' Claim, which Petitioner asserts is invalid and unenforceable under California or bankruptcy law and should be disallowed.

Dated: _____, 1992

Respectfully submitted,

PULLIAM, GRAVES & FOGEL

By: _____
Illyssa I. Fogel
Attorneys for Petitioner,
Moses N. Aslan

APPENDIX A

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In re: Moses N. Aslan, Debtor.	FILED JUL 28 1992 Cathy A. Catterson, Clerk U.S. Court of Appeals
The Hongkong and Shanghai Banking Corporation; Central Bank, Plaintiffs-Appellees v. Moses N. Aslan Defendant-Appellant	No. 89-55629 D.C. No. CV-88-4089-ER
The Hongkong and Shanghai Banking Corporation; Central Bank, Plaintiffs-Appellants, v. Moses N. Aslan, Defendant-Appellee.	No. 89-55702 D.C. No. CV-88-4089-ER ORDER

Before: REINHARDT, HALL, and RYMER,* Circuit Judges.

The panel has voted to deny appellant's petition for rehearing and to reject the suggestion for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc and no active judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

The petition for rehearing is denied and the suggestion for rehearing en banc is rejected.

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* The Honorable Pamela Ann Rymer was drawn by lot on August 27, 1991, to replace the Honorable Edward D. Re, former Chief Judge of the United States Court of International Trade, who formerly sat by designation on this panel. Judge Re retired while the petitions for rehearing were pending.

APPENDIX B

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In re: Moses N. Aslan, Debtor.	)	FILED MAY 29 1992 Cathy A. Catterson, Clerk U.S. Court of Appeals
The Hongkong and Shanghai Banking Corporation; Central Bank, Plaintiffs-Appellees v. Moses N. Aslan Defendant-Appellant	) No. 89-55629) D.C. No. CV-88-4089-ER	

The Hongkong and Shanghai Banking Corporation; Central Bank,	No. 89-55702
Plaintiffs-Appellants,	D.C. No. CV-88-4089-ER
v.	MEMORANDUM*
Moses N. Aslan,	
Defendant-Appellee.	

Appeal from the United States District Court
for the Central District of California
Edward Rafeedie, District Judge, Presiding

Argued and Submitted July 12, 1990
Pasadena, California

Before: REINHARDT, HALL, and REIMER,** Circuit Judges.

Moses N. Aslan appeals, and the Hongkong and Shanghai Banking Corporation and Central Bank ("the Banks") cross appeal, from a decision of the district court which affirmed a decision of the bankruptcy court that sustained in part, and overruled in part, Aslan's objections to an amended proof of claim filed by the Banks. We

* This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by 9th Cir. R. 36-3.

** The Honorable Pamela Ann Rymer was drawn by lot on August 27, 1991, to replace the Honorable Edward D. Re, former Chief Judge of the United States Court of International Trade, who formerly sat by designation on this panel. Judge Re retired while the petitions for rehearing were pending.

affirm.

I.

Stipulated judgments and consent decrees may be given collateral estoppel effect. *See California State Auto. Ass'n Inter-Ins. Bureau v. Superior Court*, 788 P.2d 1156, 1159 (Cal. 1990). A final judgment or order of a court cannot be reviewed or disrupted by another court in a separate, collateral proceeding unless the judgment was induced by a party's fraudulent conduct, *see Atlantic Richfield Co. v. Superior Court*, 124 Cal. Rptr. 63, 66 (Cal. App. 1975), the issuing court lacked jurisdiction, or the judgment is invalid on its face. *See Gonzales v. State*, 137 Cal. Rptr. 681, 687 (Cal. App. 1977).

None of these exceptions apply to this case. Aslan has neither challenged the jurisdiction of the state court that approved the stipulated judgment nor alleged that the judgment was induced by fraudulent statements or conduct. Aslan argues that the $8.3 million debt he owes to the Banks contains a $2 million late payment penalty that is unenforceable under California contract law. To the extent the judgment is defective on that score, it is not apparent *on the face of the judgment*; therefore, it cannot be a ground of collateral attack. The argument now raised by Aslan should have been raised in the state court prior to consenting to the stipulated judgment.

To determine whether the judgment imposes an impermissible penalty under California law, we would need to analyze all of the references in that judgment and review other evidence to determine whether the parties made the type of fair approximation of anticipated damages called for in *Garrett v. Coast & Southern Fed. Sav. & Loan Ass'n*, 511 P.2d 1197 (Cal. 1973). Such an inquiry by a federal court at this juncture would entail a far more involved

inquiry into the validity of the stipulated judgment than is permitted by principles of res judicata and collateral estoppel.

The exception to collateral estoppel set out in *Brown v. Felsen*, 442 U.S. 127 (1979) that applies when a bankruptcy court must decide whether a judgment debt ordered by a state court is *dischargeable* in bankruptcy is not applicable to the case at hand. Here, the question is whether the $8.3 million debt imposed by the judgment is valid—not whether the debt can be discharged in bankruptcy.

Nor does *In re Comer*, 723 F.2d 737, 740 (9th Cir. 1984), which held that a bankruptcy court may look behind a state court judgment and entertain evidence extrinsic to the state court record if the evidence pertains to the *nature* of the debt sought to be discharged, permit the bankruptcy court to look behind the judgment in this case. In *Comer*, we concluded that *Brown* does not allow debtors to challenge the *amount* of their debts in bankruptcy proceedings, and we denied the debtor an opportunity to challenge the extent of his alimony and child support obligations. *Id.* Aslan is similarly asking the court to determine how much he owes the Banks under the terms of the stipulated judgment (whether he owes $6.3 million under paragraph 7 of the judgment or $8.3 million under paragraph 1). Bankruptcy courts may only look at the *nature* of debts to determine whether they are dischargeable, not the amount of the debtor. *Id.*

Even if what Aslan seeks may be characterized as an inquiry into the nature of his debt to the Banks—whether the $8.3 million debt is partly an impermissible penalty—this case would still not fall within the scope of *Comer*. The *Comer* exception to collateral estoppel only allows debtors to challenge the nature of a debt in bankruptcy if *dischargeability* of the debt is in issue. The issue in this case focuses on the *validity* of the Banks' $8.3 million

claim, not its dischargeability. This type of challenge can be properly raised only on direct appeal in the state courts and is, therefore, barred in the bankruptcy court. The district court correctly refused to look behind the judgment.

II.

The Banks contend that the letter agreement either expressly or impliedly conditioned the application of the Rowan Proceeds to the stipulated judgment amount on Aslan's forbearance from attacking the judgment and his payment of all sums due thereunder. In support of this contention, the Banks state that Aslan expressly ratified, approved and affirmed the judgment and, therefore, Aslan agreed not to attack the judgment. Since Aslan has attacked the judgment, the Banks assert, he has breached the Letter Agreement and the Banks need not perform.

As support for their assertion that the Letter Agreement contains an implied covenant not to sue or not to attack the judgment, the Banks cite *College Block v. Atlantic Richfield Co.*, 254 Cal. Rptr. 179 (Cal. App. 1988), and *Northridge Hosp. Found. v. Pic 'N' Save No. 9*, 232 Cal. Rptr. 329 (Cal. App. 1986). Although the cases cited stand for the propositions stated, they involve leases, and do not support the Banks' assertion that the Letter Agreement and the stipulated judgment contain implied covenants not to sue or not to attack the judgment.

In *College Block*, the California Court of Appeal found an implied covenant of continued operation of a gas station in the lease. The lease did not set a fixed rent, but rather fixed a minimum amount plus a percentage based on the amount of gas delivered. *See College Block*, 254 Cal. Rptr. at 182. Reading the agreement as a whole, the court found that "[a] covenant of continued operation can be implied into commercial leases containing percentage rental

provisions in order for the lessor to receive that for which the lessor has bargained." *Id.* at 182. Consequently, the court concluded that an implied covenant was necessary to effectuate the intent of the parties, and that "it [was] so obvious that the parties had no reason to state the covenant." *Id.*

Here, however, the Banks have presented no evidence that indicates that the parties intended to include a covenant not to sue or not to attack the judgment, nor have the Banks presented evidence that indicates that an implied covenant not to sue or not to attack the judgment is so obvious that it need not be stated or set forth.

In *Northridge*, the question presented was whether a lessee's failure to renew the master lease "would so injure the rights of the sublessee [that] there [must] be an implied contract that the sublessor will [do so]." 232 Cal. Rptr. at 337. The court found an implied contract because the sublease contained "an absolute option to renew." *Id.* at 335. In the present case, there is no underlying agreement from which a covenant can be implied. Although *Northridge* discusses the duty of one party to an agreement not to injure the rights of the other party to the agreement, the question arose in a different context. The rights that were threatened in *Northridge* arose out of an express clause of the agreement between the lessee and the sublessee and were not implied. In the present case, the rights that the Banks claim are being threatened, namely freedom from having a court interpret a contract, are not expressly stated in the agreements.

The Banks cite no cases, and we have discovered none, that hold that a contract contains an implied covenant not to sue or not to attack the contract. Furthermore, cases that recognize an express covenant not to attack or sue also recognize that some lawsuits are allowed, as long as they are brought in good faith and not to frustrate the purpose

of the agreement. In *Winchester Drive-In Theatre, Inc. v. Warner Bros. Pictures Dist. Corp.*, 358 F.2d 432 (2d Cir. 1966), the court concluded that even if an implied covenant not to attack or sue could be held to exist, such a covenant would bar only suits that sought to attack the merits of the original suit. "It cannot be held to apply to the separate of settlement of that suit." *Id.* at 436.

In this case, for the court to imply a covenant not to sue or not to attack the judgment would be to add a term that was neither originally intended nor expected by the parties. We have noted that "courts are loathe to impose limitations or restrictions upon the parties which are not expressly contained in their agreement or which do not arise by necessary implication." *Republic Pictures Corp. v. Rogers*, 213 F.2d 662, 665 (9th Cir. 1954). Hence, under those circumstances, we have concluded that we will not imply a covenant not to sue or not to attack the judgment.

The Banks also contend that Aslan has breached the agreement because he has failed fully to perform his obligations, and, therefore the Banks need not credit the Rowan Proceeds against the judgment. As previously noted, the Banks have been paid the full amount of the judgment, including interest, less the credit of the Rowan Proceeds. Therefore, the Banks' alternative contention that Aslan has breached the agreement by failing to perform is without merit. Hence, the district court was correct in ruling that Aslan did not breach the Letter Agreement, and that he is entitled to a credit of the Rowan Proceeds.
AFFIRMED.

Judge Reinhardt dissents from Part I.

APPENDIX C

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In re: Moses N. Aslan, Debtor,	FILED MAR 25 1991 Cathy A. Catterson, Clerk U.S. Court of Appeals
The Hongkong and Shanghai Banking Corporation; Central Bank, Plaintiffs-Appellees, Cross-Appellant, v. Moses N. Aslan, Defendant-Appellant, Cross-Appellee.	Nos. 89-55629, 89-55702 D.C. No. CV88-4089-ER MEMORANDUM*

Before: REINHARDT and HALL, Circuit Judges, and

* This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by 9th Cir. R. 36-3.

RE,** Chief Judge.

Defendant-appellant, Moses N. Aslan, a debtor in bankruptcy, appeals, and plaintiffs-appellees, the Hongkong and Shanghai Banking Corporation and Central Bank, (the Banks) cross appeal, from a decision of the United States District Court for the Central District of California which affirmed a decision of the Bankruptcy Court that sustained in part, and overruled in part Aslan's objections to an amended proof of claim filed by the Banks.

Aslan, on appeal, contends that the bankruptcy court erred when it ruled that a $2,000,000 provision in a stipulated judgment entered into by the parties was valid, rather than an unenforceable penalty. The Banks, on their cross-appeal, contend that the bankruptcy court erred in ruling that Aslan did not breach a letter agreement entered into by the parties in August 1985 (the Letter Agreement) thereby losing the right to a credit of a portion of the proceeds from the resale of the Rowan Building (the Rowan Proceeds).

The questions presented by Aslan's appeal are whether the district court erred in declining to examine the terms of the stipulated judgment, and in ruling that the $2,000,000 provision was not a penalty. The question presented by the Banks' appeal is whether the district court erred in concluding that Aslan was entitled to a credit of the Rowan Proceeds.

We hold that the district court erred in ruling that the $2,000,000 provision was not a penalty. We also hold that the district court committed no error in deciding that Aslan is entitled to a credit of the Rowan Proceeds. Hence, the judgment of the district court is affirmed in part and reversed in part.

** The Honorable Edward D. Re, Chief Judge of the United States Court of International Trade, sitting by designation.

BACKGROUND

In April 1982, the Banks commenced an action against Moses N. Aslan in Los Angeles Superior Court for recovery of damages because of Aslan's alleged check kiting scheme. The Banks claimed actual damages of $3 million, punitive damages, treble damages under the Racketeer Influenced and Corrupt Organizations Act, and constructive trusts of property owned by Aslan which was allegedly purchased with the proceeds of the check kiting scheme. Based upon their claim, the Banks recorded notices of lis pendens against these properties.

In 1985, Aslan and the Banks executed a Stipulation for Entry of Judgment pursuant to settlement negotiations. Judgment was entered according to the stipulation in Los Angeles County Superior Court after a hearing before the court. During the hearing, Aslan testified that he was entering into the stipulation voluntarily, and that he was represented by counsel during the settlement negotiations.

Paragraph 1 of the stipulated judgment states that judgment shall be entered against Aslan for "the sum of $8,373,298.56, plus interest thereon at the rate of 10% per annum . . . from March 26, 1985." Notwithstanding the apparent clarity of the $8,373,298.56 amount stated in paragraph 1, paragraph 7 of the stipulated judgment expressly states:

> [p]rovided *the sum of $6,373,298.56*, plus interest thereon at 10% per annum . . . from March 26, 1985, is timely and promptly paid on or before the following dates, according to the following schedule, . . . and provided Aslan has not defaulted on any obligation or indebtedness secured by any of the Properties, the *payment of said sum shall constitute satisfaction of this Judgment*.

(emphasis added). The stipulated judgment also provided in paragraph 19 that "[i]n the event that Aslan fails to perform any of his obligations as set forth herein, plaintiffs may immediately enforce and execute upon this Judgment." The Banks may "recover the full Judgment amount and all interest thereon as set forth in paragraph 1. . . ."

In addition to the stipulated judgment, the Hongkong Bank held a first priority lien against one of Aslan's properties, known as the "Rowan Building." In the Letter Agreement, the parties agreed that, in exchange for Aslan's affirming, ratifying, and approving the terms of the stipulated judgment, the proceeds of the Bank's *resale* of the Rowan building would be applied to the amount due under the stipulated judgment.

The Hongkong Bank foreclosed on the Rowan Building lien in 1985. At the foreclosure sale, the Hongkong Bank acquired the building by successfully bidding the amount of the lien. The Hongkong Bank later resold the building at a profit.

On August 1, 1985, Aslan and the Banks entered into the Letter Agreement which stated that if Aslan ratifies, affirms, and approves all the terms in the stipulated judgment, the Banks will credit a portion of the Rowan Proceeds against the amount owing on the stipulated judgment.

On March 3, 1986, Aslan filed for bankruptcy in the Bankruptcy Court for the Central District of California. On July 28, 1986, the Banks filed an amended proof of claim and sought to recover the amounts due under the stipulated judgment. Aslan filed objections to the proof of claim on the grounds that the stipulated judgment included a $2,000,000 penalty, illegal under California law, and further, that the Banks failed to credit the Rowan Proceeds as provided in the Letter Agreement.

The bankruptcy court overruled Aslan's objection to the

$2,000,000 provision, holding that the stipulated judgment was final and not subject to modification, amendment, or reexamination. The bankruptcy court also concluded that the $2,000,000 provision did not constitute a penalty. Aslan's objection was sustained as the Rowan Proceeds, and the Banks credited the Rowan Proceeds against the stipulated judgment, as required by the Letter Agreement.

Aslan appealed to the district court the bankruptcy court's determination that the $2,000,000 provision was not a penalty, and the Banks cross-appealed the crediting of the Rowan Proceeds contending that Aslan's breach of the Letter Agreement discharged their obligations and constituted a forfeiture of the right to the credit. The district court affirmed.

The Banks have been paid $8,373,298.56, the full amount of the judgment, plus interest, less the credit of the Rowan Proceeds. On this appeal, contending that it is a penalty, Aslan seeks a refund of the $2,000,000, and the Banks seek payment in the amount of the Rowan Proceeds, which they contend is due them because of Aslan's breach of the letter agreement.

STANDARD OF REVIEW

Our review of the district court's affirmance of a bankruptcy court is substantially the same as our review of a district court. Conclusions of law are reviewed de novo, and findings of fact are reviewed under the "clearly erroneous" standard. *See* Fed. R. Civ. P. 52(a); *Ragsdale v. Haller*, 780 F.2d 794,795 (9th Cir. 1986).

DISCUSSION

I. Aslan's Appeal
   A. Res Judicata/Collateral Estoppel

In California, as elsewhere, consent agreements or stipulations to judgment may be res judicata for the claim presented. *See California State Automobile Ass'n Inter-Insurance Bureau v. Superior Court* 50 Cal 3d 658, 788 P.2d 1156, 268 Cal. Rptr. 284 (1990) (en banc); 18 C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure* § 4443 (1981). The rules of res judicata generally apply in bankruptcy proceedings as well as in other actions. *In re Comer*, 723 F.2d 737, 739 (9th Cir. 1984). Nevertheless, res judicata cannot interfere with a bankruptcy court's obligation to determine "the nature of a debt for purposes of dischargeability, if doing so would prohibit the bankruptcy court from exercising its exclusive jurisdiction to determine dischargeability." *Id.* at 740.

In the present case, Aslan asserts that the bankruptcy court is being asked to enforce a prior state court judgment that includes an illegal penalty. Such enforcement would violate the longstanding rule that bankruptcy courts will not enforce a penalty. *See In re Oahu Cabinets, Ltd.*, 12 B.R. 160, 165 (Bankr. D. Haw. 1981). In light of this long-standing rule, and because of the fact that bankruptcy courts possess broad equitable powers to distribute a debtor's estate fairly among all debtors, *see Pepper v. Litton*, 308 U.S. 295, 303-08 (1939), res judicata does not automatically bar Aslan's claim. Rather, in order to determine the "nature" of the debt, the bankruptcy court must examine the prior state court judgment and decide whether a portion of that judgment constitutes an illegal penalty. *See In re Comer*, 723 F.2d at 740. If it concludes that it does, the court need not give it preclusive effect.

B. Discount/Penalty Provision

Under California law, the language of the stipulated judgment is the appropriate starting point when deciding whether a contract provision provides for alternative performances or is an unenforceable penalty. The Califor-

nia code provides that "[t]he language of a contract is to govern its interpretation, if the language is clear and explicit. . . ." Cal. Civ. Code § 1638 (West 1985). In determining whether a provision is a penalty or an option, however, the court must also look beyond the actual language used by the parties. *See Sybron Corp. v. Clark Hosp. Supply Corp.*, 76 Cal. App. 3d 896, 902, 143 Cal. Rptr. 306, 309 (1978).

Leading authorities indicate that acceptance of the parties' language is often inappropriate. For example, the Restatement states that parties may, at times, "attempt to disguise a provision for a penalty by using language that purports to make payment of the amount an alternative performance . . . [or] purports to offer a discount for prompt performance. . . ." *Restatement (Second) of Contracts* § 356 comment c (1981). Professor Williston states that "[e]ven though what is in fact a penal sum be stated as an absolute debt, its [penal] character may, nevertheless, appear from the nature of the contract and surrounding circumstances." 5 S. Williston, *A Treatise on the Law of Contracts* § 782 (3d ed. 1961).

The terms of the stipulated judgment attempt to make the $8,373,298.56 amount appear to be the amount of the debt with the availability of a $2,000,000 discount if certain conditions are met. The Banks, on appeal, contend that the discount, and their promise to forbear from seeking title to certain of Aslan's properties, allow Aslan to decide if he would rather pay less at an earlier date and keep his properties, or pay the larger paragraph 1 amount and risk losing his properties. The stipulated judgment does not contain a date by which Aslan must pay the "total" amount of the judgment if he "elects" that alternative.

In *Garrett v. Coast and Southern Federal Savings and Loan Association*, 9 Cal. 3d 731, 511 P.2d 1197, 108 Cal. Rptr. 845 (1973), the California Supreme Court stated that

"[t]he mere fact that an agreement may be construed, if in fact it can be, to vest in one party an option to perform in a manner which, if it were not so construed, would result in a penalty does not validate the agreement." *Id.* at 737, 511 P.2d at 1200, 108 Cal. Rptr. at 848. In the present case, Aslan cannot be said to have had a choice between equally desirable alternatives. Rather, the stipulated judgment "contemplat[es] but a single definite performance with an additional charge contingent on the breach of that performance. . . ." *Id.* at 738, 511 P.2d at 1201, 108 Cal. Rptr. at 849.

Our conclusion is also supported by a decision of the California Court of Appeal. In *Chambreau v. Coughlan*, 263 Cal. App. 2d 712, 69 Cal. Rptr. 783 (1968), the plaintiff sued for $8,075. The parties entered into a stipulated judgment for $8,075 that provided that the claim would be satisfied if the defendants paid the plaintiff $5,500 according to a schedule. *See id.* at 713-14, 69 Cal. Rptr at 785. The plaintiffs sued to enforce the judgment when the defendants failed to adhere to the schedule. *See id.* The court concluded that when "'a penalty or a forfeiture is used merely to secure the payment of a debt, . . . the real thing intended by the agreement, . . . [the court] will relieve against such penalty or forfeiture. . . .'" *Id.* at 717, 69 Cal. Rptr. at 787 (quoting 2 J. Pomeroy, *A Treatise on Equity Jurisprudence* § 433 (5th ed. 1941)). *See* Cal. Civ. Code § 3275 (West 1970).

In the present case, as in *Chambreau*, the $2,000,000 was an amount intended to secure the payment of the debt. Since the true debt was for $6,373,298.56, plus interest, we hold that the $2,000,000 provision is an unenforceable penalty under California law.

II. The Bank's Cross-Appeal

The Banks contend that the letter agreement either expressly or impliedly conditioned the application of the

Rowan Proceeds to the stipulated judgment amount on Aslan's forbearance from attacking the judgment and his payment of all sums due thereunder. In support of this contention, the Banks state that Aslan expressly ratified, approved and affirmed the judgment and, therefore, Aslan agreed not to attack the judgment. Since Aslan has attacked the judgment, the Banks assert, he has breached the Letter Agreement and the Banks need not perform.

As support for their assertion that the letter agreement contains an implied covenant not to sue or not to attack the judgment, the Banks cite *College Block v. Atlantic Richfield Co.*, 206 Cal. App. 3d 1376, 254 Cal. Rptr. 179 (1988) and *Northridge Hospital Foundation v. Pic 'N' Save No. 9, Inc.*, 187 Cal. App. 3d 1088, 232 Cal. Rptr. 329 (1986). Although the cases cited stand for the propositions stated, they involve leases, and do not support the Banks' assertion that the Letter Agreement and the stipulated judgment contain implied covenants not to sue or not to attack the judgment.

In *College Block*, the California Court of Appeal found an implied covenant of continued operation of a gas station in the lease. The lease did not set a fixed rent, but rather fixed a minimum amount plus a percentage based on the amount of gas delivered. *See College Block* at 1379-80, 254 Cal. Rptr. at 182. Reading the agreement as a whole, the court found that "[a] covenant of continued operation can be implied into commercial leases containing percentage rental provisions in order for the lessor to receive that for which the lessor has bargained." *Id.* at 1380, 254 Cal. Rptr. at 182. Consequently, the court concluded that an implied covenant was necessary to effectuate the intent of the parties, and that "it [was] so obvious that the parties had no reason to state the covenant. . . ." *Id.*

Here, however, the Banks have presented no evidence that indicates that the parties intended to include a covenant

not to sue or not to attack the judgment, nor have the Banks presented evidence that indicates that an implied covenant not to sue or not to attack the judgment is so obvious that it need not be stated or set forth.

In *Northridge* the question presented was whether a lessee's failure to renew the master lease "would so injure the rights of the sublessee [that] there [must] be an implied contract that the sublessor will [do so]." 187 Cal. App. 3d at 1101, 232 Cal. Rptr. at 337. The court found an implied contract because the sublease contained "an absolute option to renew." *Id.* at 1098, 232 Cal. Rptr. at 335. In the present case, there is no underlying agreement from which a covenant can be implied. Although *Northridge* discusses the duty of one party to an agreement not to injure the rights of the other party to the agreement, the question arose in a different context. The rights that were threatened in *Northridge* arose out of an express clause of the agreement between the lessee and the sublessee and were not implied. In the present case, the rights that the Banks claim are being threatened, namely freedom from having a court interpret a contract, are not expressly stated in the agreements.

The Banks cite no cases, and we have discovered none, that hold that a contract contains an implied covenant not to sue or not to attack the contract. Furthermore, cases that recognize an express covenant not to attack or sue also recognize that some lawsuits are allowed, as long as they are brought in good faith and not to frustrate the purpose of the agreement. In *Winchester Drive-In Theatre, Inc. v. Warner Bros. Pictures Distributing Corp.*, 358 F.2d 432 (2d Cir. 1966), the court concluded that even if an implied covenant not to attack or sue could be held to exist, such a covenant would bar only suits that sought to attack the merits of the original suit. "It cannot be held to apply to the separate issue of settlement of that suit." *Id.* at 436.

In this case, for the court to imply a covenant not to sue or not to attack the judgment would be to add a term that was neither originally intended not expected by the parties. We have noted that "courts are loathe to impose limitations or restrictions upon the parties which are not expressly contained in their agreement or which do not arise by necessary implication. . . ." *Republic Pictures Corp. v. Rogers*, 213 F.2d 662, 665 (9th Cir. 1954). Hence, under these circumstances, we have concluded that we will not imply a covenant not to sue or not to attack the judgment.

The Banks also contend that Aslan has breached the agreement because he has failed fully to perform his obligations, and, therefore, the Banks need not credit the Rowan Proceeds against the judgment. As previously noted, the Banks have been paid the full amount of the judgment, including interest, less the credit of the Rowan Proceeds. Therefore, the Banks' alternative contention that Aslan has breached the agreement by failing to perform is without merit. Hence, the district court was correct in ruling that Aslan did not breach the Letter Agreement, and that he is entitled to a credit of the Rowan Proceeds.

CONCLUSION

Since we hold that the Aslan is entitled to a refund of the $2,000,000 because it is an unenforceable penalty under California law, and a credit of $3,137,209.56 from the resale of the Rowan Building, the decision of the district court is

AFFIRMED in part and REVERSED in part.

APPENDIX D

CIVIL MINUTES—GENERAL

Case No. *CV88-4089190-ER* Date *May 1, 1989*

Title *Honkong, et al. -v- Moses N. Aslan*

DOCKET ENTRY

MAY -3 1989

PRESENT:

HON. *Edward Rafeedie*, Judge

Judy Matthews	*Julie Churchill*
Deputy Clerk	Court Reporter

ATTORNEYS PRESENT FOR PLAINTIFFS:

Peter C. Bronston

ATTORNEYS PRESENT FOR DEFENDANTS:

Martin J. Brill

PROCEEDINGS: Bankruptcy Appeal Oral Argument

Counsel present and this court affirms judgment of bankruptcy court.
(Ent. MAY 03 1989) J86

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UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

In re	) Case No. LA 86-03637 GM
	)
MOSES N. ASLAN	) Chapter 11
	)
Debtor.	) FINDINGS OF FACT
	) AND CONCLUSIONS OF
	) LAW RE DEBTOR'S
	) OBJECTION TO FIRST
	) AMENDED PROOF OF
	) CLAIM FILED BY THE

) HONGKONG AND
) SHANGHAI BANKING
) CORPORATION AND
) CENTRAL BANK
)
)
) Date: September 2, 1987
) Time: 9:00 a.m.
) Place: Courtroom "G"
) 9th Floor

Hearings on the Objection ("Aslan's Objection") by debtor Moses N. Aslan ("Aslan") to the Amended Proof of Claim (the "Claim") filed by The Hongkong and Shanghai Banking Corporation ("Hongkong Bank") and Central Bank (collectively, the "Banks") were held on August 12, 1987 and September 2, 1987. At both hearings, Douglas D. Kappler of Robinson, Diamant, Brill & Klausner appeared on behalf of Aslan; at the September 2 hearing, Gary E. Klausner of the same firm also appeared for Aslan. At both hearings, Roy C. Zukerman of MacKay & Zukerman appeared for Central Bank, and Charles M. Levy, Peter C. Bronson and Kathleen P. Dority of Levy & Norminton, a Partnership of Professional Corporations, appeared for Hongkong Bank.

The Court has considered the records and pleadings on file in this case, the memoranda, declarations and other documents filed in support of and in opposition to Aslan's Objection, the evidence presented at the aforesaid hearings, and the arguments of counsel at the hearings.

GOOD CAUSE APPEARING, the Court hereby makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. Aslan, an individual, is the debtor in this bankruptcy case.

2. The Banks are secured creditors of Aslan.

3. Aslan and the Banks are parties to a Stipulation For Entry of Judgment (the "Stipulation") executed in June, 1985. The Stipulation provided for entry of judgment against Aslan and in favor of the Banks.

4. Aslan was represented by counsel at all times during the negotiation and execution of the Stipulation.

5. Judgment (the "Judgment") in accordance with the Stipulation was entered July 18, 1985 in the Los Angeles County Superior Court, following a hearing at which Aslan testified concerning, among other things, the voluntariness of the Stipulation, and during which he was represented by counsel.

6. The Judgment, among other things, awarded damages in favor of the Banks against Aslan in the sum of $8,373,298.56 plus interest thereon at the rate of 10% per annum from March 26, 1985; and stated that Aslan holds legal title to each and all of the parcels of real property (the "Properties") enumerated in the Judgment for the use and benefit of the Banks. (The Banks had recorded Notices of Lis Pendens [the "Lis Pendens Notices"] against the Properties in or about April 1982.) The Judgment further provided that Aslan could reduce the amount due the Banks from $8,373,298.56 to $6,373,298.56 by making specified time payments, including a payment of $1,619,574.64 on December 31, 1985 (the "Third Payment"), and the sum of $1,584,574.64 plus all accrued and unpaid interest on June 30, 1986 (the "Fourth Payment").

7. Aslan never appealed from, or sought modification of or any relief from, the Judgment.

8. Aslan and the Banks entered into a Letter Agree-

ment (the "Letter Agreement") on or about August 1, 1985, by the terms of which, among other things, Aslan ratified, affirmed and approved all the terms and provisions of the Judgment; Aslan agreed to indemnify the Banks against various potential claims; and the Banks agreed to credit, against the Judgment, net proceeds of $3,137,-209.58 (including a $500,000 reserve for taxes), derived from the resale by Hongkong Bank of a building known as the Rowan Building, upon which Hongkong Bank had foreclosed. The Letter Agreement recited that no partial satisfaction of judgment need be filed with respect to the first $3,000,000 (the "Indemnity Fund") in principal reductions of the Judgment until, among other things, the Banks had been paid in full all amounts due under the Judgment and there was no possibility that the Banks would need to resort to the Indemnity Fund.

9. Aslan did not receive less than reasonably equivalent value for the consideration given by him pursuant to the Stipulation.

10. Between approximately December, 1985 and February, 1986, the Banks negotiated with Nassim H. Mussry ("Mussry") concerning the possible sale of the Judgement to Mussry. Mussry executed a Letter of Intent (the "Letter of Intent") dated December 30, 1985, in which, among other things, he signified his intention to purchase the Judgment, and agreed to indemnify the Banks against claims arising from the sale of the Judgment and from the sale or resale of the Rowan Building. The Letter of Intent also recited that if the Banks determined that they and Mussry would be unable to reach an agreement for sale of the Judgment, then Aslan would have, from that point, five days within which to make the Third Payment. Mussry paid a deposit of $2,000,000 pursuant to the Letter of Intent.

11. The Banks and Mussry failed to reach an agreement for sale of the Judgment to Mussry.

12. On February 20, 1986, the Banks' counsel notified Mussry in writing that, to the extent the Letter of Intent created any binding agreement, the Banks rescinded the Letter of Intent. The Banks returned Mussry's $2,000,000 deposit concurrently with that notification.

13. Also on February 20, 1986, the Banks' counsel notified Aslan in writing that the Letter of Intent had been rescinded, but offered to recommend to the Banks, notwithstanding the rescission, that if Aslan made the Third Payment within five days, *i.e.*, on or before February 25, 1986, the payment would be treated as timely.

14. Aslan filed his Chapter 11 petition herein on March 3, 1986. He had not made the Third Payment, and still has not done so.

15. The Fourth Payment was due on or before June 30, 1986. Aslan failed to make the Fourth Payment, timely or at all.

16. Neither the confirmed Trustee's Amended Plan of Reorganization nor any of the reorganization plans submitted by Aslan in this case purported to cure, under Bankruptcy Code Sections 1123 and 1124 or otherwise, any payment default by Aslan under the Judgment. (The Court has not found or concluded that such cure could have been effected in this case under those Sections.)

17. Aslan has not cured any default under the Judgment that could have been cured by making the Third Payment and Fourth Payment, or either of them.

18. To the extent that any of the foregoing findings of fact may be construed as a conclusion of law, it is hereby deemed to be a conclusion of law.

CONCLUSIONS OF LAW

19. To the extent that any of the following conclusions of law may be construed to be a finding of fact, it is

hereby deemed to be a finding of fact.

20. The liens created by the Judgment, in favor of the Banks, relate back to the recording of the Lis Pendens Notices.

21. Neither the Stipulation nor the Judgment constituted a fraudulent transfer.

22. The Judgment is final, and this Court will not modify, amend, abrogate or re-examine the Judgment.

23. The Judgement does not contain or involve any unenforceable penalty or forfeiture.

24. By virtue of the Letter Agreement, Aslan ratified, affirmed and approved all the terms and provisions of the Judgment, and his doing so comprised consideration for the Banks' agreement to credit $3,137,209.58 against the Judgment as aforesaid. As a result, this Court will not modify, amend, abrogate or re-examine the Judgment.

25. Section 362 of the Bankruptcy Code did not toll the time for Aslan to make the Fourth Payment. Section 108(b) of the Bankruptcy Code governed any right of Aslan to reduce the Judgment amount by making such payment.

26. Aslan failed to timely reduce the total Judgment amount from $8,373,298.56 to $6,373,298.56 by making the Fourth Payment within the time prescribed by Bankruptcy Code Section 108(b).

27. Aslan's Objection, to the extent it seeks to reduce the principal amount of the Claim by $2,000,000, is without merit by reason of Aslan's failure to make the Fourth Payment within the time prescribed by Bankruptcy Code Section 108(b).

28. Aslan's Objection as to the aforesaid $2,000,000 is overruled.

29. Aslan's Objection is sustained in part, in that he is entitled to a credit, against the full Judgment amount of $8,373,298.56 plus interest, in the sum of $3,137,209.58, plus interest thereon at 10 percent per annum from and after the date Hongkong Bank received the proceeds from

its resale of the Rowan Building, at such time as (and only to the extent that) the Trustee has determined that such sums will not be needed for payment of any of the actual or potential claims against which the Letter Agreement indemnifies the Banks.

THE HONORABLE GERALDINE MUND
United States Bankruptcy Judge

PRESENTED BY:

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UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

In re	) Case No. LA 86-03637 GM
	)
MOSES N. ASLAN	) Chapter 11
	)
Debtor.	) ORDER ON DEBTOR'S
	) OBJECTION TO FIRST
	) AMENDED PROOF OF
	) CLAIM FILED BY THE
	) HONGKONG AND
	) SHANGHAI BANKING

) CORPORATION AND
) CENTRAL BANK
)
) Date: September 2, 1987
) Time: 9:00 a.m.
) Place: Courtroom "G"
_____) 9th Floor

Hearings on the Objection ("Aslan's Objection") by debtor Moses N. Aslan ("Aslan") to the Amended Proof of Claim (the "Claim") filed by The Hongkong and Shanghai Banking Corporation ("Hongkong Bank") and Central Bank (collectively, the "Banks") were held on August 13, 1987 and September 2, 1987. At both hearings, Douglas D. Kappler of Robinson, Diamant, Brill & Klausner appeared on behalf of Aslan; at the September hearing, Gary E. Klausner of the same firm also appeared for Central Bank, and Charles M. Levy, Peter C. Bronson and Kathleen P. Dority of Levy & Norminton, a Partnership of Professional Corporations, appeared for Hongkong Bank.

The Court has considered the records and pleadings on file in this case, the memoranda, declarations and other documents filed in support of and in opposition to Aslan's Objection, the evidence presented at the aforesaid hearings, and the arguments of counsel at the hearings. Based on separate Findings of Fact and Conclusions of Law issued by this Court, and good cause otherwise appearing,

IT IS HEREBY ORDERED that:

1. Aslan's Objection, to the extent it seeks to reduce the principal amount of the Claim by $2,000,000, is overruled.

2. Aslan's Objection is sustained in part, in that he is entitled to a credit of $3,137,209.58, plus interest thereon at 10 percent per annum from and after the date Hongkong Bank received the proceeds from its resale of the building known as the Rowan Building, against the $8,373,298.56

plus interest which is the full amount of the Judgment entered in favor of the Banks and against Aslan on July 18, 1985 in the Los Angeles County Superior Court, at such time as (and only to the extent that) the Trustee has determined that such sums will not be needed for payment of any of the actual or potential claims against which the Letter Agreement dated August 1, 1985 between Aslan and the Banks indemnifies the Banks.

/s/
THE HONORABLE GERALDINE MUND
United States Bankruptcy Judge

PRESENTED BY:

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Supreme Court, U.S.
FILED
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(2)

No. 92-745

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1992

IN RE MOSES N. ASLAN,
Debtor.

MOSES N. ASLAN,
Petitioner,

v.

THE HONGKONG AND SHANGHAI BANKING CORPORATION AND CENTRAL BANK,
Respondents.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

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QUESTIONS PRESENTED FOR REVIEW

Petitioner's statement of the questions presented is erroneous. First, Petitioner asserts that the Ninth Circuit Court of Appeals erred in affirming the Bankruptcy Court's failure to look behind a stipulated state court judgment to determine the *validity* of a creditor's claim against the bankruptcy estate. In fact, the *validity* of the claim is not in issue; the Bankruptcy Court merely, and properly, refused to look behind the stipulated judgment to determine the *amount* of the claim. Second, Petitioner asserts that the Bankruptcy Court erred "in failing to disallow the $2 million penalty portion" of Respondents' bankruptcy claim under the Judgment. In fact, the Bankruptcy Court made no finding that the claim included any penalty and, to the contrary, found that there was no penalty.

Accordingly, the questions presented are these:

1. Did the Ninth Circuit Court of Appeals err in affirming, on *res judicata* principles, the Bankruptcy Court's and District Court's refusal to look behind a stipulated state court judgment to determine the amount of a creditor's claim against the bankruptcy estate, where the judgment was not procured by fraud and the state court had jurisdiction to render it?

2. If, notwithstanding principles of *res judicata*, the Bankruptcy Court was required to look behind and revisit the stipulated state court judgment, did the discount for early payment, for which the judgment provided, constitute an unenforceable penalty?

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OPINIONS BELOW

Petitioner's Reports of Opinion Below [Petition, p. 2] erroneously states that Respondents suggested a rehearing *en banc* after the Court of Appeals issued its May 29, 1992 Memorandum Opinion (the "Opinion"). However, only Petitioner sought any rehearing after the issuance of the Opinion.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

In addition to the provisions which Petitioner contends are involved, Respondents refer to:

28 U.S.C. § 1738.

The Acts of the legislature of any State, Territory, or Possession of the United States, or copies thereof, shall be authenticated by affixing the seal of such State, Territory or Possession thereto.

The records and judicial proceedings of any court of any such State, Territory or Possession, or copies thereof, shall be proved or admitted in other courts within the United States and its Territories and Possessions by the attestation of the clerk and seal of the court annexed, if a seal exists, together with a certificate of a judge of the court that the said attestation is in proper form.

Such Acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken.

STATEMENT OF THE CASE

A. Factual Background.

The Statement of the Case in Moses N. Aslan's ("Aslan") Petition for Writ of Certiorari (the "Petition" or "Pet.") contains material misstatements, and omits relevant facts. Accordingly, Respondents The Hongkong and Shanghai Banking Corporation

("Hongkong Bank") and Central Bank (sometimes collectively "the Banks")[1] set forth the factual background in some detail.

1. The Banks' Judgment Against Aslan.

In early April, 1982, the Banks learned that Aslan had stolen millions of dollars from them by perpetrating a "check kite" between accounts he maintained in the two Banks. [Appellant's (Aslan's) District Court Excerpts of Record ("A.D.C.E.") at 220.] When confronted, Aslan admitted that he had taken about $3.2 million from the Banks by writing checks on his Hongkong Bank account with the knowledge that there was insufficient money in the account to cover such checks. Aslan deposited the checks into his Central Bank account, and wrote bad checks on that account to cover the Hongkong Bank checks. Aslan and his accountant both admitted that Aslan had invested the proceeds of the kite in Aslan's real property holdings, and that obligations secured by those properties could not have been met without the stolen funds. [A.D.C.E. at 220; Appellants' (Banks') District Court Excerpts of Record ("B.D.C.E.") at 732-733.][2]

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[1]Pursuant to Supreme Court Rule 29.1: Hongkong Bank is a wholly owned subsidiary of HSBC Holdings plc. Hongkong Bank's subsidiaries (other than wholly owned subsidiaries) are Aspiration Land Investment Ltd.; Banking Computer Services Pte. Ltd.; Collyer Quay Properties Ltd.; Electronic Payment Services Co. (HK) Ltd.; Eltis Precision Printing Ltd.; Hang Seng Bank Ltd.; The Hong Kong Futures Guarantee Corporation, Ltd.; Hongkong and Shanghai Thomas Cook Ltd.; The International Investment Company of Chile S.A.; Isoba Ltd.; Ocean Properties Pte. Ltd.; Ocean Towers Pte. Ltd.; Ortigas and Company Limited Partnership; Plimmer City Centre Ltd.; Tindalk Ltd.; Vinebel Realties Ltd.; and Xinjiang World Plaza Hotel Ltd. Central Bank, now known as Bank of the West, is a wholly owned subsidiary of Banque Nationale de Paris. Bank of the West has no non-wholly-owned subsidiaries.

[2]Contrary to Aslan's assertion [Pet. at 5 n.2], the record below is not "totally silent" on Aslan's liability for the check kite. In addition to the plain admissions cited above, the Banks' claim squarely recited that it was based on the check kite [A.D.C.E. at 2], a recital never challenged by Aslan; the Banks' counsel referred to the check kite in oral argument

The Banks commenced an action against Aslan in the Los Angeles County Superior Court in April, 1982 (not December, 1983 as intimated in the Petition) for recovery of the proceeds from the check kite and interest thereon, punitive damages for fraud, treble damages under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), and other relief. Because Aslan had admitted investing the stolen funds in his properties, the Banks sought imposition of a constructive trust on Aslan's real properties, and recorded notices of lis pendens against the subject real properties. [A.D.C.E. at 144, 220-221.][3]

In addition to the check kite, Aslan had defaulted on a loan from Hongkong Bank secured by a deed of trust on the Rowan Building. Although Aslan delayed Hongkong Bank's collection efforts by purporting to transfer the building to Quinbros Investment Partnership ("Quinbros") and placing Quinbros in an involuntary bankruptcy case, Hongkong Bank obtained relief from the automatic stay in the Quinbros case on the ground of bad faith, and scheduled the foreclosure sale of the Rowan Building. Aslan and his then-counsel, Charles T. Rose ("Rose"), appeared at the scheduled sale on March 26, 1985, and negotiations took place concerning settlement of Aslan's obligations to the Banks. [A.D.C.E. at 221-222, 275-276.]

Hongkong Bank's counsel, Charles M. Levy ("Levy"), explained to Rose and Aslan that the Banks' losses far exceeded the principal amount of the check kite. In addition, interest had accrued; and the Banks were entitled to share in the tremendous appreciation in the value of Aslan's real properties, because Aslan admittedly had used funds from the check kite to meet his real property obligations. [B.D.C.E. at 317-322, 732-733.] The Banks claimed the right to additional damages under RICO, and punitive damages. Levy proposed settlement for at least $10,000,000

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without objection [*see, e.g.*, A.D.C.E. at 684-685]; and Aslan flatly admitted to his counsel that he had perpetrated the check kiting scheme against the Banks. [B.D.C.E. at 753.]

[3]Aslan has continually and falsely asserted that the Banks only sued him for $3,151,158.22, the principal amount of the check kite [Pet. at 4]. The record, and the Judgment, demonstrate otherwise.

(including the amount owed on the Rowan Building loan). [A.D.C.E. at 220-222, 276.] Aslan and Rose agreed that Aslan would stipulate to judgment in favor of the Banks in the sum of $10,000,000, reducible, at Hongkong Bank's option, by the amount owed on the Rowan Building;[4] and for possession of the real properties.

Levy told Rose that the Banks were hesitant to rely upon Aslan to perform his stipulated obligations because of his prior conduct: Aslan had reneged on at least two agreements to sell real property; he had refused to sign a stipulation for relief from stay in favor of United Overseas Bank ("UOB") in the Quinbros bankruptcy case after having agreed in open court to do so; he had unsuccessfully sought to avoid obligations under a contract with UOB; and, on Hongkong Bank's motion for relief from stay, the Quinbros case had been held a bad-faith bankruptcy. In light of this history, Levy told Rose that Aslan needed an incentive, in the form of a discount for prompt payment, in order to create any hope that Aslan would voluntarily meet his obligations to the Banks. [A.D.C.E. at 222-223.] Thus, it was agreed that if Aslan made four timely installment payments, the Banks would discount the full amount of the Judgment by $2,000,000, and would give up its rights in the real estate. [A.D.C.E. at 26, 222, 276.] At the Courthouse in Norwalk on March 26, 1985, where the Rowan Building foreclosure sale had been set, the parties all signed a handwritten stipulation, to be later transcribed and re-signed, for entry of judgment on those terms. [A.D.C.E. at 222, 276.][5]

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[4]The Judgment was so reduced, to the principal sum of $8,373,298.56. [A.D.C.E. at 5, 223-225.]

[5]The Petition falsely asserts that Hongkong Bank's counsel made statements to the effect that the $2,000,000 discount "was intended to be a penalty to be assessed against the Debtor if he failed to meet his obligations under the Stipulated Judgment." [Pet. at 6.] Aslan's assertion, which bears no citation to the record, is false on two grounds. First, the record shows that Hongkong Bank's counsel did not make the statements attributed to him. Second, Aslan continues to refer to his *option* to keep his properties and reduce the Judgment amount, by making specified time payments, as *obligations*. [Pet. at 6.] The Judgment never obligated Aslan to make any installment payments; it

Aslan initially attempted to renege on the stipulation; but after a meeting with his counsel, Aslan decided to honor his commitments. [A.D.C.E. at 276-277.] Thereafter, the foreclosure sale of the Rowan Building was periodically continued while a more detailed written Stipulation for Entry of Judgment was negotiated and prepared. [A.D.C.E. at 223, 276-277.] The Banks agreed to several of Aslan's requests for changes in the March 26 stipulation, including giving Aslan six more months to make his payments. [A.D.C.E. at 223, 276-277.]

No agreement was reached concerning the foreclosure sale of the Rowan Building, and the sale was held on June 11, 1985. Hongkong Bank was the successful bidder, buying the property for the loan indebtedness of $1,694,010.66. Thereafter, on June 28, 1985, Hongkong Bank resold the Rowan Building for $5,000,000. Meanwhile, the final formal Stipulation For Entry Of Judgment was completed, executed, and presented to a judge of the Los Angeles County Superior Court for approval at a hearing on July 18, 1985. Aslan testified at the hearing, in the presence of Rose, his counsel, that he desired to end the litigation and was stipulating to entry of judgment against him freely, voluntarily, and without duress. [Banks' Supplemental Excerpts of Record ("B.S.E.R.") in Court of Appeals, at 9-10.][6] After the judge questioned Aslan about it, the Judgment was approved and

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merely gave him the option to keep his properties, make the installment payments, and thereby obtain a $2,000,000 discount if he chose to do so. [A.D.C.E. at 26; Bankruptcy Court Finding of Fact No. 6, A.D.C.E. at 494.]

[6]Although Aslan alleges that he "was under extreme financial pressure to resolve his dispute with the Banks" [Pet. at 4], the record is entirely to the contrary. The Bankruptcy Court specifically found that the Judgment was the result of negotiation and compromise, and that Aslan received reasonably equivalent value for the consideration given by him pursuant thereto [Petition, Appendix ("App.") E-4]; Aslan was represented throughout by counsel; and no contention was ever made that the Bank improperly coerced Aslan to enter into the stipulated Judgment. Moreover, the Judgment was entered after a full Superior Court hearing, at which Aslan testified that no duress had been imposed upon him to enter into the stipulation. [B.S.E.R. at 1-13.]

entered. [A.D.C.E. at 5-36, 224, 278; B.S.E.R. at 13.] No appeal was taken, and no other relief from the Judgment was sought.

The Judgment was (a) for damages of $8,373,298.56 plus 10% interest, (b) that Aslan held legal title to enumerated parcels of real property for the use and benefit of the Banks, and (c) that the Banks had the right to demand transfer of record title to the properties. In addition, the Judgment recited that so long as Aslan had not defaulted on any obligations secured by the properties, he could satisfy the Judgment (and thus keep the properties) by timely making four specified payments totaling $6,373,298.56 plus interest. The first two payments, of $1,584,574.64 each, were due July 1 and September 30, 1985 respectively; the third payment of $1,619,574.64 was due December 31, 1985; and the remaining balance was due June 30, 1986. The Judgment also provided that if the Banks took title to the properties, they would remit to Aslan all sale proceeds therefrom in excess of the full Judgment amount ($8,373,298.56) plus all interest thereon. [A.D.C.E. at 5-36, 224-225, 278.]

2. The Parties' Post-Judgment Letter Agreement.

After entry of Judgment the parties negotiated an August 1, 1985 Letter Agreement (the "Letter Agreement"), whereby Hongkong Bank agreed to credit against the Judgment the net profits of $3,137,209.58 which Hongkong Bank had realized from the resale of the Rowan Building. [A.D.C.E. at 225-226, 278-279.] This extremely generous credit would have enabled Aslan to make the first two time payments under the Judgment. However, it was *expressly conditioned* upon, among other things, Aslan's affirming, ratifying and performing all of his obligations under the Judgment including, most importantly, timely paying all the sums required; and his approving the Rowan Building resale. [A.D.C.E. at 38, 41, 225-226.] Rose explained in detail to Aslan, his client, that if Aslan failed to perform all the terms and conditions of the Judgment, including payment of all sums due thereunder, or attacked the Judgment, Aslan would forfeit any right to the credit from the resale of the Rowan Building. [B.D.C.E. at 749-750.]

3. Aslan's Failure To Make Payments.

Aslan contended in the Bankruptcy Court that the Rowan Building resale profits would cover the first two installments under the Judgment. Issues then arose concerning his admitted failure to make, timely or at all, the third and fourth payments.

The third payment was due December 31, 1985. At that time, Amana Corporation ("Amana") had been negotiating with the Banks for purchase of the Judgment, and Amana had executed a letter of intent (the "Letter of Intent") on December 30, 1985. [A.D.C.E. at 155-158.] Amana deposited $2,000,000 which would have constituted a down payment on the purchase of the Judgment, and the Banks prepared a draft purchase agreement based on the Letter of Intent. [A.D.C.E. at 159-167.] However, new and changed terms demanded by Amana prevented consummation of any agreement.[7] Amana's deposit was returned, and the Letter of Intent was rescinded on February 20, 1986. [A.D.C.E. at 227.]

The Letter of Intent provided that if negotiations were unsuccessful, Hongkong Bank would return Amana's deposit and Aslan would then have five days to make the third installment payment. When the Amana negotiations terminated, the Banks, although the Letter of Intent had been rescinded, still left the door open for Aslan to perform the Letter Agreement and tender the third payment to the Banks within five days (*i.e.*, by February 25, 1986). However, no such tender was made. [A.D.C.E. at 227-228, 274.]

Aslan filed his Chapter 11 Petition on March 3, 1986, well after the expiration of the deadline for the third payment. Aslan never tendered either the third payment or the fourth and final payment,

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[7]The Petition erroneously asserts, without any citation to the record, that Amana rejected the Banks' counterproposal to the Letter of Intent "because the Banks added certain indemnification provisions which were unacceptable to the Amana Corporation." [Pet. at 7.] In fact, the Letter of Intent did not result in an agreement, not because of terms requested by the Banks, but because of certain indemnifications *demanded by Amana*. [A.D.C.E. at 227.]

the deadline for which was June 30, 1986. [Findings of Fact Nos. 14-15; A.D.C.E. at 496.][8]

B. Procedural Background.

Aslan's summary of the procedural background of this case [Pet. at 7-9] is erroneous in two respects.

First: In two different places, the Petition asserts that after the Ninth Circuit issued its Opinion filed May 29, 1992, both Aslan and the Banks requested a rehearing. [Pet. at 2, 9.] The Banks did not request any rehearing after the May 29 Opinion was issued; only Aslan requested a rehearing, and his petition was denied. The Petition's suggestion to the contrary gives the false impression that both sides are dissatisfied with the Opinion.

Second: Aslan alludes ambiguously to an "offset issue" which was the subject of the Banks' cross-appeal in the Ninth Circuit. Aslan asserts that the "offset issue is not a part of this appeal." [Pet. at 9.] The "offset issue" relates to the Banks' contention, in the Ninth Circuit, that because Aslan was attacking the Judgment, he should not be entitled to retain the profits from the resale of the Rowan Building, the consideration for which was Aslan's ratification and payment of the entire Judgment.[9] The

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[8]The filing of the bankruptcy did not stay the deadline for the third payment. Bankr. Code § 108(b). However, the Bankruptcy Court did not need to make a finding on that point, because Aslan also failed to make the fourth payment within the "grace period" of Section 108(b), which failure, the Bankruptcy Court ruled, precluded Aslan from obtaining the $2,000,000 discount. Pet. App. E-6. Aslan does not challenge that determination.

[9]Aslan mischaracterizes the Letter Agreement in two respects. First, he states that by the Letter Agreement, the Banks agreed to give Aslan a credit from the sale of the Rowan Building. In fact, Hongkong Bank purchased the Rowan Building at its own foreclosure. It subsequently *resold* the building, and agreed to give Aslan a credit in the amount of the net profits (not "proceeds" as stated by Aslan) from the *resale*. Second, although Aslan's own counsel candidly referred to the Letter Agreement as a "pure gift" to Aslan [B.D.C.E. at 754], in fact the Banks understandably did not simply give Aslan more than $3,000,000

Ninth Circuit Court of Appeals held that Aslan's attack on the Judgment did not impair his right to the Rowan Building credit, in part because the Banks were, by virtue of the Opinion, recovering the full amount of the Judgment. [Pet. App. C-11.]

The Banks' contentions with regard to the Rowan Building profit will be renewed only if Aslan's Petition is granted. The Banks argue hereinbelow that Aslan's Petition falls far short of the showing required, and should be denied; but as a matter of caution, the Banks are filing a Cross-Petition for Writ of Certiorari concurrently herewith, to be considered only if the Court grants Aslan's Petition. In other words, the Banks will accept the result below, but reserve the contention that if Aslan is somehow held entitled to a $2,000,000 refund under the Judgment by virtue of his "penalty" argument, then either this Court or, on remand, the Bankruptcy Court after an evidentiary hearing, should determine whether any successful attack on the Judgment by Aslan vitiates his right to the Rowan Building profit.

ARGUMENT: ASLAN'S PETITION SHOULD BE DENIED

A. Summary of Argument.

Aslan invested the multi-million-dollar proceeds of a check kite in real estate. When the victim Banks discovered the check kite and sued Aslan, Aslan chose to save his real estate holdings and compromise the amount of the Banks' damages by entering into a stipulated Judgment, entered by a California court of competent jurisdiction, after a full hearing at which Aslan was represented by counsel and testified that he stipulated to the Judgment freely and without duress. He never sought any relief from the Judgment in the California courts. The Judgment is, under California law, valid, final and enforceable in all respects.

The Judgment included an option by which Aslan could reduce the judgment amount by $2,000,000, and retain his real property holdings, by making four timely installment payments to the

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without consideration. That consideration consisted of Aslan's agreement to ratify, affirm, approve and pay the entire Judgment. [A.D.C.E. at 41-42.]

Banks. After his deadline for making the third payment had expired, Aslan filed a bankruptcy petition. In the Bankruptcy Court, he attacked the $2,000,000 discount provision as an unenforceable penalty. The Bankruptcy Court properly concluded that because Aslan has not challenged the Judgment in the California courts, and did not contend that the Judgment was procured by fraud or that the California courts had lacked jurisdiction, there was no basis for a collateral attack in the Bankruptcy Court, and that *res judicata* prohibited the Bankruptcy Court from reopening the state court Judgment. The Court also concluded that because the Banks, by virtue of its ruling, were receiving the entire Judgment amount, consideration had not failed for the Rowan Building credit. The District Court and Court of Appeals agreed, and affirmed.

Aslan now seeks review in this Court, on the stated ground that the Ninth Circuit's Opinion "has so far departed from the accepted and usual course of judicial proceedings . . . as to call for an exercise of this Court's power of supervision." S.Ct. R. 10.1(a). The Petition fails to set forth any justification for further review by this Court, for the following reasons:

1. The Ninth Circuit Opinion is entirely consistent with the decisions of at least eight other Circuits and of this Court, and does not conflict with the decisions of any Circuit.

2. The Opinion not only fails to depart, radically or at all, "from the accepted and usual course of judicial proceedings", but also is manifestly correct. Collateral estoppel does apply in bankruptcy courts, such that a final state court judgment may not be collaterally attacked unless one of the specific exceptions to the *res judicata* doctrine — fraud or lack of jurisdiction — is urged and established.

B. This Case Is Inappropriate For Certiorari.

The principal argument of Aslan's Petition is that Bankruptcy Courts have inherent equitable power to reject or reduce the amount of a claim in bankruptcy, even if the claim and its amount are based on a final judgment of a state court of competent jurisdiction, and even if no fraud is alleged or proved.

As the Banks will explain, acceptance of Aslan's position would require rejection of the decisions of every Circuit which has considered the question — there are, including the Ninth Circuit panel which rendered the Opinion in this case, at least nine — and overruling of this Court's decision in *Grogan v. Garner*, ____ U.S. ____, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). It is settled that principles of *res judicata* do apply in bankruptcy court, unless one of the recognized exceptions is established — fraud or lack of jurisdiction, neither of which was even urged here.

There is no conflict among the circuits. [S.Ct. R. 10.1(a); *cf. Braxton v. United States*, ____ U.S. ____, 111 S.Ct. 1854, 1857, 114 L.Ed.2d 385 (1991) (a principal purpose for certiorari jurisdiction is to resolve conflicts among Circuits concerning the meaning of provisions of federal law).] There is no new or important issue here. [*Cf. Reading Co. v. Brown*, 391 U.S. 471, 474-475, 88 S.Ct. 1759, 20 L.Ed.2d 751 (1968).] Nor does the Opinion conflict with any decision of this Court. [S.Ct. R. 10.1 (c).] Accordingly, this is not an appropriate case for certiorari, which "will be granted only when there are special and important reasons therefor." [S.Ct. R. 10.1.]

Aslan, conceding that the usual bases for certiorari are lacking, relies *entirely* on the proposition that the Opinion "has so far departed from the accepted and usual course of judicial proceedings . . . as to call for an exercise of this Court's power of supervision." [Pet. at 10; S.Ct. R. 10.1(a).]

As the Banks will explain, had the Ninth Circuit adopted Aslan's position, it would have been the only circuit to do so. Instead, its Opinion complied in every way with "the accepted and usual course of judicial proceedings". It is Aslan's argument — that the Bankruptcy Courts should have virtually unfettered rights to ignore principles of *res judicata* whenever a judge believes it would be equitable to do so—that contravenes all the applicable authorities. Accordingly, this case bears no resemblance to those in which this Court's supervisory powers were appropriately invoked to review decisions which could have radically affected the administration of justice in the federal courts. *See, e.g., McNabb v. United States*, 318 U.S. 332, 340-341, 63 S.Ct. 608, 87 L.Ed. 819 (1943).

Under these circumstances, Aslan's Petition fails to meet any of the recognized standards and should be denied.

C. Bankruptcy Courts Do Not Have Equitable Power To Deny *Res Judicata* Effect to Final, Valid State Court Judgments.

Even if Aslan somehow could be held to have met the standards for granting of a writ of certiorari, nevertheless the Ninth Circuit's Opinion must be affirmed, because Aslan neither urged nor established any exception to application of *res judicata*.

1. Introduction: Bankruptcy Courts Are Bound By Principles Of *Res Judicata*.

It is well established that a bankruptcy court is required to give full faith and credit to a final state court judgment. *Heiser v. Woodruff*, 327 U.S. 726, 733, 66 S.Ct. 853, 90 L.Ed. 970, *reh. denied*, 328 U.S. 879, 66 S.Ct. 1335, 90 L.Ed. 1647 (1946); *In Re Morton*, 43 Bankr. 215, 218 (Bankr. E.D.N.Y. 1984). This requirement is codified in 28 U.S.C. Section 1738, which states in relevant part:

> "[The] Acts, records and judicial proceedings [of any state, territory or possession of the United States] . . . shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken." 28 U.S.C. § 1738.[10]

Aslan argues that a bankruptcy court may use its equitable powers to reopen and "look behind" a final state court judgment, without giving it *res judicata* effect. [Pet. at 13.] Aslan's argument is meritless. The cases he cites support the Banks' position that the courts below properly applied *res judicata*, and were required to do so.

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[10]Although Section 1738, by its terms, calls for the extension of "full faith and credit" to state court judgments, the courts in applying this section have interpreted it as a requirement that federal courts give "*res judicata* effect" to state court judgments. *See, e.g., In Re Morton*, 43 Bankr. at 217. This Brief will adopt the courts' terminology and refer to the "*res judicata* effect" of prior state court judgments.

2. The Bankruptcy Court Met Its Responsibility To Effect A Fair Result.

Contrary to Aslan's assertions, the Bankruptcy Court did not ignore its responsibility to equitably administer a debtor's estate. [Pet. at 10.] Indeed, the Bankruptcy Court, mindful of its duties, made meticulous findings, including a specific finding that the Judgment does not contain or involve an unenforceable penalty or forfeiture. [Conclusion of Law No. 23, A.D.C.E. at 497.]

3. Neither Of The Two Recognized Exceptions To *Res Judicata* Is Present Here.

There are only two accepted grounds for a bankruptcy court to deny *res judicata* effect to a state court judgment: fraud and lack of jurisdiction. Neither of those grounds has even been asserted in this case. As this Court explained in *Heiser v. Woodruff:*

> "Undoubtedly, since the bankruptcy act authorizes a proof of claim based on a judgment, such a proof may be assailed in the bankruptcy court on the ground that the purported judgment is not a judgment because of want of jurisdiction of the court which rendered it over the persons of the parties or the subject matter of the suit, or because it was procured by fraud of a party . . . *But it is quite another matter to say that the bankruptcy court may reexamine the issues determined by the judgment itself. It has from an early date been held to the contrary. . . .*
>
> *"Neither Pepper v. Litton . . . nor the other cases which [respondents] cite, sustain the contention that the bankruptcy court, in passing on the validity of creditors' claims, may disregard the principles of res judicata." Heiser v. Woodruff,* 327 U.S. at 737 (emphasis added).

Since *Heiser*, the courts have recognized that these two equitable grounds for challenging a prior judgment — lack of jurisdiction and fraud in the procurement — are narrow, and were not meant to undermine the basic principles of *res judicata. See, e.g., In Re Morton*, 43 Bankr. at 218; *In Re Oulman*, 75 Bankr. 232, 235 (N.D. Iowa 1987), *aff'd*, 851 F.2d 1032 (8th Cir. 1988). Aslan has never alleged that the California state court that

entered the Judgment lacked jurisdiction, or that the Judgment was obtained by fraud. Accordingly, no equitable grounds existed that would have permitted the lower courts to refuse to apply the doctrine of *res judicata* to uphold the Judgment.

Indeed, all of the cases cited in Aslan's Petition support the Banks' position that the lower courts correctly applied the doctrine of *res judicata*. In addition to *Heiser v. Woodruff*, Aslan relies on *Margolis v. Nazareth Fair Grounds and Farmers Market*, 249 F.2d 221 (2d Cir. 1957), *Pepper v. Litton*, 308 U.S. 295, 60 S.Ct. 238, 84 L.Ed. 281 (1939), and *Kelleran v. Andrijevic*, 825 F.2d 692 (2d Cir. 1987), *cert. denied*, 484 U.S. 1007, 108 S.Ct. 701, 98 L.Ed.2d 652 (1988).

In *Margolis*, unlike this case, judgment creditors' claims in bankruptcy were susceptible to collateral attack based on evidence that the judgments had been fraudulently procured. 249 F.2d at 224. Similarly, this Court in *Pepper* upheld the decision of the district court disallowing the salary claim of the controlling stockholder of a debtor corporation, where the state court judgment on which the claim was based had been obtained as the result of a "planned and fraudulent scheme." 308 U.S. at 312. Thus, both *Margolis* and *Pepper* invoked the fraud exception to *res judicata*.

Likewise, in *Kelleran*, the Second Circuit Court of Appeals reversed the Bankruptcy Court's refusal to give a state court default judgment binding effect. The Court properly held:

> " 'Congress has specifically required all federal courts to give preclusive effect to state-court judgments whenever the courts of the State from which the judgments emerged will do so. . . .' *Allen v. McCurry*, 449 U.S. 90, 96, 101 S.Ct. 411, 415, 66 L.Ed.2d 308 (1980) (citing 28 U.S.C. § 1738 (1982)). Bankruptcy courts fall within Congress' mandate." 828 F.2d at 694.

Significantly, Aslan is forced to rely on the *dissent* of District Judge Blumenfeld in *Kelleran*; the dissenting judge urged that because the judgment in that case had been obtained by default, and not after litigation on the merits, the judgment should be reopened. 825 F.2d at 698-699. Even if the dissent reflected the

state of the law — which it does not — nevertheless the Judgment in this case suffered from no such infirmities. It was entered after a full hearing, and with the consent of Aslan.[11] Indeed, any doubt about whether principles of collateral estoppel apply in bankruptcy cases was resolved by this Court last year in *Grogan v. Garner, supra*, in which the Court held:

> "Our prior cases have suggested, but have not formally held, that the principles of collateral estoppel apply in bankruptcy proceedings under the current Bankruptcy Code. See, *e.g.*, *Kelly v. Robinson*, 479 U.S. 36, 48, n.8, 107 S.Ct. 353, 360, n.8, 93 L.Ed.2d 216 (1986); *Brown v. Felsen*, 442 U.S., at 139, n.10, 99 S.Ct. at 2213, n.10. Cf. *Heiser v. Woodruff*, 327 U.S. 726, 736, 66 S.Ct. 853, 857, 90 L.Ed. 970 (1946) (applying collateral estoppel under an earlier version of the bankruptcy laws.) Virtually every court of appeals has concluded that collateral estoppel is applicable in discharge exception proceedings [citing Court of Appeals decisions of six circuits]. Cf. *In re Rahm*, 641 F.2d 755, 757 (CA 9) (prior judgment establishes only a prima facie case of nondischargeability), cert. denied *sub nom. Gregg v. Rahm*, 454 U.S. 860, 102 S.Ct. 313, 70 L.Ed.2d 147 (1981). *We now clarify that collateral estoppel principles do indeed apply in discharge exception proceedings pursuant to section 523(a).*" ____U.S. at ____, 111 S.Ct. at 658 n.11 (emphasis added).

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[11]Aslan also cites Bankruptcy Court decisions which, even if they were deemed influential, are obviously distinguishable. In *In re Fazio*, 41 Bankr. 865 (Bankr. E.D. Pa. 1984), a claim based on a state court judgment was *upheld* because no exception to *res judicata* had been alleged. And in *In re Bus Stop, Inc.*, 3 Bankr. 26 (Bankr. S.D. Fla. 1980), the amount of a claim under a judgment which accelerated the rent, after a lease default, for the entire lease term was reduced in accordance with a provision of the Bankruptcy Code expressly limiting the *amount* of such a claim to fifteen percent of the rent due for the remaining term.

Every Circuit appears now to be in accord with this principle.[12] Specifically, state court judgments were held entitled to collateral estoppel effect in bankruptcy proceedings in at least the following cases: *In re Halpern*, 810 F.2d 1061 (11th Cir. 1987); *In re Braen*, 900 F.2d 621, 630 (3d Cir. 1990); *Combs v. Richardson*, 838 F.2d 112, 115 (4th Cir. 1988); *Klingman v. Levinson*, 831 F.2d 1292 (7th Cir. 1987); *Matter of Shuler*, 722 F.2d 1253 (5th Cir.), *cert. denied*, 469 U.S. 817, 105 S.Ct. 85, 83 L.Ed.2d 32 (1984); *Goss v. Goss*, 722 F.2d 599 (10th Cir. 1983); *Lovell v. Mixon*, 719 F.2d 1373 (8th Cir. 1983); and *Spilman v. Harley*, 656 F.2d 224 (6th Cir. 1981).

In re Halpern involved facts nearly identical to those presented here. A debtor had consented to the entry of a state court judgment against him in a suit brought by First Georgia Bank ("First Georgia") alleging that the debtor had engaged in a check-kiting scheme. The $337,000 consent judgment provided that if debtor complied with a specified payment schedule, the judgment would be satisfied by total payment of $250,000. 810 F.2d at 1062. The debtor, like Aslan in this case, failed to meet the payment schedule and filed for bankruptcy. The Court held that the state court judgment collaterally estopped the debtor from relitigating the facts supporting it, stating:

> "Moreover, the consent judgment on its face evinces that [debtor] received consideration in exchange for agreeing that the judgment would constitute a final adjudication of the findings.[5] There is no evidence of coercion or duress, and the consent judgment was signed by both [debtor] and by his attorney. Under such circumstances, the bankruptcy court correctly concluded that '*[a] chilling effect on consent judgments and settlements might result if the court were to ignore*

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[12] *Grogan v. Garner* impliedly overruled a Ninth Circuit decision, *In re Rahm*, 641 F.2d 755 (9th Cir.), *cert. denied sub nom. Gregg v. Rahm*, 454 U.S. 860, 102 S.Ct. 313, 70 L.Ed.2d 147 (1981), cited in *Grogan* as the only Circuit Court case which had failed to apply collateral estoppel in discharge exception proceedings. 111 S.Ct. at 658 n.11. The Opinion in the instant case did not invoke *In re Rahm*, and is consistent with *Grogan v. Garner*.

such a clear and unambiguous expression of the parties' intent.'

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[5]This consideration consisted of First Georgia's agreement to accept $250,000 in full satisfaction of [debtor's] $337,000 debt if [debtor] met the payment schedule."

810 F.2d at 1065 (emphasis added).

Thus, there is no conflict in the Circuits over the point argued by Aslan. All the courts agree that a bankruptcy claim based on a final, valid state court judgment is entitled to collateral estoppel effect in the bankruptcy courts, absent fraud or lack of jurisdiction.

4. The Equitable Powers Of The Bankruptcy Courts Do Not Include The Power To Abrogate *Res Judicata.*

Although Aslan refers to the bankruptcy courts' equitable power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]" [Bankr. Code § 105(a)], such powers are limited. "Section 105 does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code or mandates of other state and federal statutes." [2 King, *Collier on Bankruptcy* ¶ 105.01[3], at 105-4 (15th ed. 1992) (fns. omitted).] *See, e.g., Official Committee of Equity Security Holders v. Mabey*, 832 F.2d 299, 302 (4th Cir. 1987), *cert. denied*, 485 U.S. 962, 108 S.Ct. 1228, 99 L.Ed.2d 428 (1988). Specifically, Section 105 is not "a roving commission to do equity," and does not give the bankruptcy court authority to contravene *res judicata* by relitigating or reexamining a final judgment. *Browning v. Navarro*, 887 F.2d 553, 559 (5th Cir. 1989), *reh. denied*, 894 F.2d 99 (5th Cir. 1990); *accord, In re Alston*, 49 Bankr. 929, 933 (Bankr. E.D.N.Y. 1985).[13]

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[13]Even if Aslan's expansive view of Bankruptcy Code Section 105(a) were accepted, this is not a case which the equities favored relieving Aslan from his stipulation. Not only did Aslan agree to the Judgment at a full court hearing, but also he later ratified and reaffirmed the

D. The Court of Appeals Properly Applied the Doctrine of *Res Judicata* To Uphold the Banks' Claim Based on a Final, Valid State Court Judgment.

1. Aslan Cannot Relitigate a Final California Judgment in the Federal Courts.

As explained above, a final, valid judgment was entered in a California state court against Aslan. Aslan cannot challenge the finality of the Judgment. He did not appeal; indeed, as Aslan concedes [Pet. at 18], a stipulated judgment normally is not appealable. Nor did he seek any reconsideration, modification or other relief in the California courts.

Under *res judicata*, "a final judgment on the merits bars further claims by parties or their privies based on the same cause of action." *In re A-1 24 Hour Towing, Inc.*, 33 Bankr. 281, 284 (Bankr. D. Nev. 1983), *quoting Montana v. United States*, 440 U.S. 147, 153, 99 S.Ct. 970, 59 L.Ed.2d 210 (1979). Furthermore, *res judicata* prevents the litigation not only of any defenses that were asserted or determined in the prior proceeding, but also those that *could have been* asserted or determined. *In re A-1 24 Hour Towing, Inc.*, 33 Bankr. at 284; *Brown v. Felsen*, 442 U.S. 127, 132, 99 S.Ct. 2205, 60 L.Ed.2d 767 (1979). "[F]inal judgments of the courts serve a useful social function and are not lightly disturbed." *In re Ridill*, 1 Bankr. 216, 218-219 (C.D. Cal. 1979).[14]

Thus, Aslan cannot relitigate whether he is liable to the Banks, and for what amount. These issues were resolved by the Judgment entered more than seven years ago in the state court.

Judgment, in the Letter Agreement, making the application of *res judicata* even more compelling.

[14]As Justice Story wrote, "it is for the public interest and policy to make an end to litigation . . . that suits may not be immortal, while men are mortal." *Ocean Ins. Co. v. Fields*, 18 F.Cas. 532, 539, 2 Story 59 (C.D.D. Mass. 1841).

2. Stipulated Judgments Are Entitled to Preclusive Effect Under 28 U.S.C. Section 1738.

The fact that the Judgment was entered by stipulation does nothing to detract from its being considered a conclusive determination. *Greene v. Ancora-Citronelle Corp.*, 577 F.2d 1380, 1383 (9th Cir. 1978). Absent an "allegation that the parties did not intend the stipulation to finally determine the issues", a stipulated judgment is final and binding on the parties. *In re Levinson*, 58 Bankr. 831, 836 (Bankr. N.D. Ill. 1986), *aff'd*, 831 F.2d 1292 (7th Cir. 1987).[15]

More than four years after the entry of the Judgment, Aslan contended for the first time in the Ninth Circuit that he was "under extreme financial pressure to resolve his dispute with the Banks" [Pet. at 4] and therefore agreed to the Judgment. These new references to "financial pressure" are not only unsupported by the record but also irrelevant. Even if there were evidence supporting such references, "financial pressure" is not a ground for invalidating a judgment on a collateral attack. Moreover, Aslan testified that he entered into the stipulation without duress, and in the Letter Agreement he later ratified and affirmed the stipulation. Finally, claims not raised in the trial court are waived and may not be considered on appeal. *Stephen v. Arrow Lumber Co.*, 354 F.2d 732, 734 (9th Cir. 1966). Accordingly, the stipulated Judgment is entitled to preclusive effect.

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[15]It is noteworthy that even default judgments, and judgments by confession, have been afforded conclusive effect in subsequent bankruptcy proceedings. For example, in *In Re Fazio, supra*, 41 Bankr. 865, 867 (Bankr. E.D. Pa. 1984), a creditor's claim based on a state court confessed judgment was held not subject to attack by the debtor in a bankruptcy proceeding. Likewise, in *In Re New-Com Corp.*, 72 Bankr. 90, 95 (Bankr. W.D. Pa. 1987), the Court held that a default judgment barred the relitigating of an action, where the debtor had made no attempt to open or strike the judgment in the court which rendered it. *See also In Re A-1 24 Hour Towing, Inc.*, 33 Bankr. at 286.

E. Federal Courts Will Not Inquire Into the Amount of a Final State Court Judgment.

Aslan asks this Court, as he asked the Bankruptcy Court, District Court and Court of Appeals, to redetermine the amount of the Judgment. But such inquiry would violate 28 U.S.C. § 1738. Other courts faced with the same request have rejected it, and have enforced the prior judgment.

For example, in *In re Comer*, 723 F.2d 737, 740 (9th Cir. 1984), the Court of Appeals affirmed the decision of the bankruptcy court that it was precluded by *res judicata* from looking behind a state court judgment adverse to the debtor to determine the actual amount of the debtor's obligation. In dischargeability proceedings, the bankruptcy court had refused to admit evidence attacking the extent of the debtor's obligation, finding such evidence to be irrelevant and barred by *res judicata*. In affirming, the Court of Appeals stated:

> "Failing to apply *res judicata* under these circumstances would allow a bankrupt who has had full incentive to litigate, and who has fully litigated, an issue in state court . . . to have that same issue relitigated in the bankruptcy courts." *In re Comer*, 723 F.2d at 740.

Accord, Kelleran v. Andrijevic, supra, 825 F.2d at 695 (Court of Appeals, citing the preclusive effect of a final state court judgment, invoked *res judicata* even where lower courts had determined that judgment creditor's "claims were so outrageous as to warrant independent review of the liability issues decided in the state court").

The extent of Aslan's obligation to the Banks has already been determined in state court. As the authorities cited above make clear, and as three courts correctly have recognized, the Bankruptcy Court was bound by that determination.

1. The Judgment Would Be Given Full Effect in California and Must Be Afforded Like Effect by a Federal Court.

Aslan argues that (a) the bankruptcy court has the power to look into the factual merits of a state court judgment; and (b) the

Judgment in this case includes a "penalty" unenforceable under California and bankruptcy law and, therefore, should not have been recognized by the Bankruptcy Court. [Pet. at 14-21.] The Banks will meet below Aslan's characterization of part of the Judgment as a "penalty". Yet, even if the Judgment did contain a "penalty", it would be entitled to *res judicata* effect under California and bankruptcy law.

2. Aslan Was Not Deprived Of An Opportunity To Contest The Banks' Claim.

Aslan first relies heavily on *Margolis v. Nazareth Fair Grounds & Farmers Market, Inc., supra*, 249 F.2d 221 (2d Cir. 1957). However, *Margolis* supports the Banks.

In *Margolis*, a bankruptcy referee has disallowed claims based on a judgment by confession, after determining that there was no legal basis for the claims, that there were defenses, and that the creditors, who were former directors of the bankrupt debtor, had engaged in fraud in obtaining the judgments. Thus, invoking *Heiser v. Woodruff*, the Court recognized the well-settled fraud exception to *res judicata*. 249 F.2d at 224-225. From *Margolis*, Aslan attempts to argue that the stipulated Judgment in this case was entered after Aslan "defaulted on the payment of a debt" without an opportunity to raise defenses. [Pet. at 16.]

Even if, contrary to the authorities, a default judgment were not entitled to full faith and credit, Aslan's argument ignores the facts. First, he did not merely default on the payment of a debt; he stole money from the Banks through a check-kiting scheme. He invested the stolen proceeds in his buildings. Second, he was not deprived of any opportunity to present a defense; he stipulated freely and without duress to a judgment that would exonerate him from further liability and would offer the option of making specified payments in order to save his buildings. Third, Aslan does not even allege that there was fraud in obtaining the Judgment.

3. Under California Law, the Banks' Judgment Is Not Subject to Collateral Attack.

Aslan also repeats his failed argument that the $2,000,000 discount portion of the Judgment is unenforceable under California law as an impermissible penalty. He continues to ignore the critical distinction between the *direct review* of a judgment in a proceeding instituted in a proper state court for that specific purpose, and a *collateral attack* on a judgment, such as the one attempted here.

The Bankruptcy Court, District Court and Court of Appeals all recognized that Aslan's Objection to the Banks' Claim was an impermissible collateral attack on the underlying Judgment.

> "A collateral attack is made, not in a proceeding brought for the specific purpose of attacking the judgment, but in some other proceeding having a different purpose — *it is an attempt to avoid the effect of a judgment or order made in some other proceeding.*" *Gonzales v. State of California*, 68 Cal.App.3d 621, 632, 137 Cal.Rptr. 681 (1977) (emphasis added).

Aslan sought to avoid the effect of the Judgment, not in an action brought for that purpose, but in the bankruptcy case. Aslan's challenge was, therefore, collateral, and was governed by the rules applicable to collateral attacks.

In California, a judgment is *res judicata* and conclusive between the parties as to its subject matter. Cal. Code Civ. Proc. § 1908(a)(2).

> "It is the general rule that a final judgment or order is *res judicata* even though contrary to statute where the court has jurisdiction in the fundamental sense, i.e., of the subject matter and the parties. Lack of jurisdiction in the fundamental sense is essential, ordinarily, for collateral attack." *City and County of San Francisco v. Pacello*, 85 Cal.App.3d 637, 642, 149 Cal.Rptr. 705 (1978), *citing Pacific Mutual Life Ins. Co. v. McConnell*, 44 Cal.2d 715, 285 P.2d 636 (1955), *cert. denied and appeal dismissed*, 350 U.S. 984, 76 S.Ct. 472, 100 L.Ed. 851 (1956).

"[I]f such invalidity or want of jurisdiction does not appear on the face of the record, it will be presumed in favor of the former judgment or order." *Gonzales v. State of California*, 68 Cal.App.3d at 632. Thus, even an erroneous judgment, once final, is as conclusive as a correct one. *People v. Cotton Belt Ins. Co.*, 143 Cal.App.3d 805, 808, 194 Cal.Rptr. 210 (1983); *People v. Silva*, 114 Cal.App.3d 538, 550, 170 Cal.Rptr. 713 (1981). This result is mandated by the important policies of finalizing judgments and ending protracted litigation, which policies are applicable in both bankruptcy and non-bankruptcy proceedings. *In Re Garafano*, 99 Bankr. 624, 630 (Bankr. E.D. Pa. 1989).

Because Aslan never challenged the jurisdiction of the state court that entered the Judgment, the Judgment is "presumptively valid and immune from collateral attack." *In re Marriage of Stier*, 178 Cal.App.3d 42, 47, 223 Cal.Rptr. 599 (1986).

4. The Cases Cited by Aslan Are Inapposite.

Aslan's argument that the Judgment involves a "penalty" rests on three California cases. Aslan cites *Sybron Corp. v. Clark Hospital Supply Corp.*, 76 Cal.App.3d 896, 143 Cal.Rptr. 306 (1978); *Garrett v. Coast & Southern Fed. Sav. & Loan Assn.*, 9 Cal.3d 731, 108 Cal.Rptr. 845, 511 P.2d 1197 (1973); and *Los Angeles City School District v. Landier Investment Co.*, 177 Cal.App.2d 744, 2 Cal.Rptr. 662 (1960) for the proposition that the California courts will not allow the imposition of a penalty, and that, therefore, the Bankruptcy Court should have reduced the amount of the Banks' Claim under the Judgment. [Pet. at 17.] The three cases are wholly inapplicable to this proceeding, because they involved *direct review* of judgments; none arose upon a *collateral attack* on a judgment. As a result, the reviewing courts did not need to consider the *res judicata* effect of the judgments.

Thus, in *Sybron Corp. v. Clark Hospital Supply Corp.*, a buyer and seller of hospital beds entered into a settlement agreement which provided for the entry of judgment in the seller's favor should the buyer fail to make certain payments. When the buyer defaulted, the seller obtained a judgment. Two months later, the buyer moved to set aside the judgment. The buyer's motion was

denied by the trial court, but upheld on direct appeal, by the California Court of Appeal, on the ground that part of the judgment constituted a penalty.

Similarly, *Los Angeles City School District v. Landier Investment Co.* arose on direct appeal from a trial court's denial of the defendants' motion for relief from judgment brought approximately four years after judgment had been entered. Due to defendants' delay in seeking relief, the appellate court affirmed the trial court's order denying relief despite the claim that part of the judgment was a penalty. Thus even if the case were otherwise applicable — which it is not — it demonstrates that any rights Aslan would have had to seek relief in the California Courts have long since lapsed.

Finally, in the *Garrett* case, the California Supreme Court, on direct appeal, reversed a judgment dismissing the plaintiffs' action, holding that excessive late charges under a loan agreement were not valid liquidated damages but, rather, a penalty.

Clearly, the cases cited by Aslan were all decided on direct, not collateral, attacks.

> "A direct attack is a proceeding instituted for the specific purpose of vacating, reversing, or otherwise attacking the judgment as by motion for new trial, motion to vacate, appeal, an independent action in equity, and by certiorari or other writs." *Gonzales v. State of California*, 68 Cal.App.3d at 632.

The Courts below have correctly invoked the distinction between direct review and collateral attack. On direct review, a court may look behind the judgment for error. In a collateral attack, only a judgment rendered by a court lacking jurisdiction or procured by fraud may be denied *res judicata* effect.

The Judgment was *not* before the Bankruptcy Court on direct review. Nor could it be; the United States Supreme Court is the only federal court to which a final state court judgment may be appealed (28 U.S.C. § 1257). All other federal courts, including bankruptcy courts, lack jurisdiction to review a state court judgment on the merits. *In re James*, 940 F.2d 46, 53 (3d Cir. 1991);

see District of Columbia Court of Appeals v. Feldman, 460 U.S. 462, 476, 103 S.Ct. 1303, 75 L.Ed.2d 206 (1983). The Banks' Judgment was before the Bankruptcy Court "only incidentally" as part of Aslan's Objection to the Banks' Claim. As a result, the Judgment may not be reviewed for error, and the cases cited by Aslan are irrelevant. Furthermore, as explained above, no grounds exist for a collateral attack upon the Judgment.

F. The Judgment Does Not Contain a Penalty Provision, Nor Is Aslan Entitled to Relief Under California Statutory Law.

1. The California Courts Will Not Construe a Contract as Effecting a Forfeiture Unless There Is No Other Reasonable Interpretation.

The Courts below were bound by *res judicata* to uphold the Banks' Claim based on the Judgment. However, even if the Courts had been permitted to reopen issues decided by the Judgment, they would have had to find that the Judgment did *not* contain any penalty provisions. Indeed, the Bankruptcy Court expressly found that the Judgment does not contain any penalty or forfeiture. [A.D.C.E. at 497.]

Aslan's Petition conveniently ignores many other terms and conditions contained in the Judgment in addition to the optional discount for early payment. [A.D.C.E. at 26.] Most important, the Judgment recites that the Banks beneficially own enumerated real properties. [A.D.C.E. at 5, 25.] Also under the Judgment, it was agreed that if the Banks exercised their right to demand record title to the properties, they would remit to Aslan all sale proceeds therefrom in excess of the full Judgment amount plus interest. [A.D.C.E. at 33-34.]

The amount of the Judgment, and the Banks' right to the properties, resulted from Aslan's admission that he not only stole millions of dollars from the Banks by his check kite, but also invested proceeds from his check kite in real properties. Accordingly, the Banks were entitled to share in any appreciation of the properties realized by Aslan through use of the Banks' money; that appreciation amounted to millions of dollars. The Banks also were entitled to punitive damages for fraud and treble damages

under RICO. The Banks agreed to discount the Judgment amount for prompt installment payments, in the hope that such a provision would induce Aslan to do what historically he never had done: perform his contractual obligations.

The Judgment clearly states that the Banks own the properties; and that Aslan has the choice of, in effect, buying back his properties for timely payment of $6,373,298.56 or future payment of $8,373,298.56. A seller of real estate, of course, can set whatever price he wants for the property. Thus the terms to which Aslan agreed were consistent with the analogous "time-price" doctrine, which provides:

> "[T]he owner of property, whether real or personal, has a perfect right to name the price on which he is willing to sell, and to refuse to accede to any other. He may offer to sell at a designated price for cash or at a much higher price on credit. . . ." *Verbeck v. Clymer*, 202 Cal. 557, 563, 261 P. 1017 (1927).

Likewise, it was Aslan's choice whether to pay $6,373,298.56 and retain his properties, or at a later date to either pay $2,000,000 more or suffer the sale of sufficient properties to satisfy his obligation to the Banks. Under such circumstances, where the obligor has a rational choice between alternatives, there is no "penalty" involved because the selection of one option over the other is not a breach at all. *Blank v. Borden*, 11 Cal.3d 963, 970-971, 115 Cal.Rptr. 31, 524 P.2d 127 (1974); *Western Camps, Inc. v. Riverway Ranch Enterprises*, 70 Cal.App.3d 714, 726-727, 138 Cal.Rptr. 918 (1977).

The California courts will not construe an agreement as effecting a forfeiture or penalty "unless no other interpretation is reasonably possible." *ABI, Inc. v. City of Los Angeles*, 153 Cal.App.3d 669, 682, 200 Cal.Rptr. 563 (1984). It was reasonable (and completely accurate) for the lower courts to interpret the Judgment as providing for a discounting of an acknowledged obligation for early payment, on the one hand, or a higher "price" over a longer time, and *not* a penalty upon default. Moreover, the Banks were entitled to damages far in excess of their out-of-pocket loss. The California courts would be compelled to find that

the Judgment was enforceable in the full amount of $8,373,298.56 plus interest.

2. The Bankruptcy Cases Cited by Aslan Regarding Penalties Are Inapplicable.

Aslan cites two bankruptcy court cases for the general proposition that a bankruptcy court will not enforce a penalty, or a liquidated damages clause that is in reality a penalty. [Pet. at 18.] This general principle simply has no application to the facts of this case. The Judgment does not contain or involve a penalty or liquidated damages clause. Moreover, the facts of the cases cited by Aslan to support these general propositions are distinguishable from the facts in this case.

For example, Aslan cites *In Re Oahu Cabinets, Ltd.*, 12 Bankr. 160 (Bankr. D. Hawaii 1981). Even if this bankruptcy court case had any value as precedent, it is still entirely inapplicable. *In Re Oahu* did not involve a judgment; therefore, the court was not required to consider *res judicata*. The issue was whether a landlord was entitled to collect interest and collection fees on past due lease rental payments from a Chapter 11 debtor/tenant. The bankruptcy court refused to enforce a lease provision imposing interest, costs, attorneys' fees and other charges, because it was an "effort to extract a penalty for late payment." *In Re Oahu Cabinets, Ltd.*, 12 Bankr. at 165.

The Chapter 11 debtor/tenant in *In Re Oahu* had breached the lease agreement by failing to make his rental payments. Aslan's failure to make the installment payments was *not* a breach or default under the Judgment. The unenforceable lease provision in *In Re Oahu* became effective only in the event of a default by the debtor/tenant. *In Re Oahu*, 12 Bankr. at 164. In this case, the amount of the Judgment was at all times more than $8 million; it did not become $8 million as a result of Aslan's decision not to make the installment payments.

Nor was there a judgment involved in *In Re Klefstad*, 95 Bankr. 622 (Bankr. E.D. Ark. 1988). [Pet. at 18.] In that case, a tax penalty, not reduced to judgment, was disallowed.

3. Even If the Judgment Contained a Penalty Provision, Aslan Would Not Be Entitled to Relief Under California Law.

Even if it were determined that Aslan could collaterally attack the Judgment *and* that the Judgment contained a penalty provision, nevertheless it still is invulnerable to attack because the methods to challenge it, under California law, either are inapplicable or can no longer be exercised because of the passage of time.

First, assuming Aslan could have appealed from the stipulated Judgment, his time to appeal expired years ago. Rule 2, Cal. Rules of Court.

Second, the time to assert mistake, inadvertence or error as a ground for relief from the effect of the Judgment under California Code of Civil Procedure Section 473 expired no later than six months after entry of the July 18, 1985 Judgment. Other than appeal, this was the only remedy, if any, which Aslan could have pursued in the Los Angeles County Superior Court — *if* he believed there were changed facts or excusable neglect entitling him to relief from his Stipulation for Entry of Judgment. *See Roth v. Morton's Chefs Services, Inc.*, 173 Cal.App.3d 380, 385-386, 218 Cal.Rptr. 684 (1985). Aslan not only failed to seek relief from the Judgment; by the Letter Agreement, he expressly ratified and approved the Judgment, which conduct furnished a separate and independent ground for the lower courts' refusal to look behind the Judgment. [Conclusion No. 24, A.D.C.E. at 497.]

G. If A Writ of Certiorari Were Issued and Aslan Prevailed on His Argument that *Res Judicata* Does Not Apply, Then the Entire Case Should Be Remanded to the Bankruptcy Court.

Even if, on some basis, Aslan persuaded this Court that a writ of certiorari should issue, and if Aslan's argument that the Bankruptcy Court was not bound by *res judicata* were found to have merit, nevertheless Aslan would not be entitled on the record herein to any reduction of the Judgment amount; the entire case would have to be remanded to the Bankruptcy Court.

Because the Bankruptcy Court did not find any basis for abrogating *res judicata*, no evidentiary hearing was necessary, so none was held, on whether the Judgment included a penalty. Indeed, the Banks have shown that the Judgment reflected a reasonable compromise and reduction of Aslan's liability. An evidentiary hearing would so establish.

Likewise, the Banks contend that if Aslan prevailed on his "penalty" argument, then consideration would have failed for the Banks' agreement, in the Letter Agreement, to give Aslan the Rowan Building resale profit in exchange for Aslan's ratifying, affirming, approving and fully performing the Judgment. For that reason, the Banks, as a matter of caution, have filed a Cross-Petition for Writ of Certiorari concurrently herewith, even though they will accept the Opinion as it now stands.

While the Banks submit that Aslan's Petition plainly must be denied, they respectfully request that if Aslan's Petition is granted and Aslan ultimately prevails on the merits, the entire case be remanded to the Bankruptcy Court for appropriate factual determinations.

H. Conclusion.

Aslan's Petition should be denied.

Respectfully submitted,

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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1992

IN RE MOSES N. ASLAN,
Debtor.

THE HONGKONG AND SHANGHAI BANKING CORPORATION AND CENTRAL BANK,
Cross-Petitioners,

v.

MOSES N. ASLAN,
Cross-Respondent.

BRIEF OF CROSS-RESPONDENT IN OPPOSITION TO CROSS-PETITION FOR WRIT OF CERTIORARI

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STATEMENT OF THE CASE

The Cross-Respondent set forth a clear and concise statement of the facts upon which the Petition for Writ of Certiorari (the "Petition") is based in the Petition. The Cross-Petitioners greatly elaborated on these facts in their Brief for Respondents in Opposition (the "Brief in Opposition"). This expanded statement of the facts was referenced in their Cross-Petition for Writ of Certiorari (the "Cross-Petition") along with their version of the facts upon which the Cross-Petition rests.[1]

The Cross-Respondent submits that the additional "facts" asserted by the Cross-Petitioners contain numerous allegations made by various persons in declarations filed in support of a number of pleadings in the courts below, that these allegations were and are disputed by the Cross-Respondent, and that most if not all of these allegations cannot be considered "facts" for the purposes of this appeal. The Cross-Petitioners' statement of the facts goes far beyond a clear and concise statement of the undisputed facts and contains numerous misstatements.

To remedy this, the Cross-Respondent will recite herein the undisputed material facts upon which the Petition and Cross-Petition are based, and then point out the misstatements in the Cross-Petitioners' Brief in Opposition and Cross-Petition.

A. Statement of the Facts Material to the Petition.

The Cross-Petitioners are the holders of a disputed claim against the bankruptcy estate of Moses N. Aslan who is the Cross-Respondent herein and the debtor in a Chapter

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[1]The Hongkong and Shanghai and Central Banks shall be referred to as "Cross-Petitioners" and Moses N. Aslan shall be referred to as "Cross-Respondent" herein.

11 case currently pending in the Central District of California. The claim arose when the Cross-Petitioners filed a lawsuit against Aslan and others alleging in part that Aslan was involved in a check kiting scheme and alleging actual damages in the amount of $3,151,158.22 plus interest, punitive damages, treble damages under RICO and other relief. The Third Amended Complaint was filed in December 1983.

At the time, the Cross-Respondent owned several parcels of real estate in the City of Los Angeles. Claiming entitlement to a constructive trust, the Cross-Petitioners recorded lis pendens upon all of these parcels, making it virtually impossible for the Cross-Respondent to remedy his financial affairs without first satisfying the Cross-Petitioners. With respect to one of these parcels, known as the Rowan Building, the Cross-Petitioners also held a deed of trust and commenced foreclosure proceedings in December 1984.

The lawsuit was eventually settled on or about March 25, 1985, the date set for the foreclosure of the Rowan Building, by an agreement that was subsequently memorialized in the Stipulated Judgment. The Stipulated Judgment provided for entry of a judgment against the Cross-Respondent and in favor of the Cross-Petitioners in the amount of $8,373,298.56, plus interest, or alternatively for conveyance of legal title of the parcels of real estate to the Cross-Petitioners, and for reduction of the judgment to $6,373,298.56 upon timely payment of that amount in installments due on July 1, 1985, September 30, 1985, December 31, 1985, and June 30, 1986, among other provisions.

Subsequently, the characterization of the $2 million difference between the $8,373,298.56 judgment sum and the $6,373,298.56 reduced judgment sum has been the subject of much dispute between the Cross-Respondent and the Cross-Petitioners. The Cross-Respondent has contended

that this $2 million constitutes an illegal penalty and as such should not be allowed as part of the Cross-Petitioners' bankruptcy claim. This argument was first made in the Cross-Respondent's objection to the Cross-Petitioners' Amended Proof of Claim, which was filed on or about July 28, 1986 in the amount of $9,401,032.96. No evidentiary hearing on this issue has ever been held in the bankruptcy court.

B. Statement of the Facts Material to the Cross-Petition.

On or about June 11, 1985, after postponing the foreclosure sale on the Rowan Building for some time, the Cross-Petitioners finally held their foreclosure sale. The Cross-Petitioners were the successful bidders, credit bidding the amount of $1,694,010.66, the amount due under the note secured by the lien on the Rowan Building. In July 1985, the Cross-Petitioners sold the Rowan Building to the Rowan Development Corporation for $5,000,000.00.

Shortly thereafter, on August 1, 1985, the Cross-Respondent and the Cross-Petitioners entered into the Letter Agreement, pursuant to which the Cross-Petitioners agreed to, and did, credit the net proceeds of the Rowan Building resale to the full and complete payment of the July 1, 1985, and September 30, 1985, installment payments referenced in the Stipulated Judgment. The Letter Agreement also contained provisions requiring Aslan to ratify, affirm and approve all of the provisions of the Stipulated Judgment.

The Cross-Petitioners contend that the Letter Agreement required the Cross-Respondent to forbear from attacking the Stipulated Judgment in order to receive the benefits of the credit of the Rowan Building resale. The Cross-Respondent disputes this position. The Bankruptcy Court ruled that Aslan was entitled to the credit provided in the Letter Agreement. This ruling was affirmed by the District Court and by the Ninth Circuit Court of Appeals.

C. Misstatements of Fact in the Brief in Opposition and Cross-Petition.

The Cross-Petitioners have repeatedly included "facts" in briefs submitted below and in this Court that are based on inadmissible hearsay contained in declarations filed in support of various pleadings submitted to the courts below. These so-called facts must be disregarded by this Court in considering the Petition and Cross-Petition.

First, the Cross-Petitioners assert that the Cross-Respondent admitted he engaged in a check kiting scheme. This is a distortion of the record. The Cross-Petitioners cite to the declarations of Charles Levy and Douglas Wiita, both of whom are or were counsel for the Cross-Petitioners, respecting statements they purportedly heard the Cross-Respondent make. Not only are these statements hearsay, but neither declarant has ever been subjected to cross-examination with respect to their declarations.

The Cross-Petitioners also seem to find it significant that the Cross-Respondent did not specifically object to the check kiting assertion in the Amended Proof of Claim filed by the Cross-Petitioners nor object when the Cross-Petitioners' counsel repeated the allegation in oral argument on the issue of whether the Cross-Respondent could be in default of his obligation to make the fourth payment after the filing of the bankruptcy case. Failure to object in these circumstances, however, does not lead to the conclusion that the Cross-Respondent admitted he had engaged in check kiting. The Cross-Respondent urges the Court to note that neither the Stipulated Judgment, the Letter Agreement nor the Bankruptcy Court's Findings of Fact contain any admission or finding that the Cross-Respondent engaged in the alleged check kiting scheme. The fact is that the Cross-Respondent has consistently denied such allegation.

Second, the Cross-Petitioners allege that the Cross-Respondent has misstated the facts by stating that the

lawsuit was based on a claim of actual damages in the amount of $3,151,158.22 plus interest. Although the Cross-Respondent concedes that the Cross-Petitioners also sued for punitive damages and other relief under other counts, the fact remains that the Cross-Petitioners claimed that the amount of the alleged check kite was approximately $3.1 million.

Further, in the Brief in Opposition, the Cross-Petitioners claim that the Cross-Respondent admitted using funds from the alleged check kiting scheme to meet his real property obligations. As support for these "facts," the Cross-Petitioners again cite to inadmissible hearsay statements of its own counsel. The Cross-Petitioners also cite the Disclosure Statement prepared by the Chapter 11 Trustee in support of the Trustee's Plan; however, nothing in the pages cited of the Disclosure Statement has anything to do with the alleged admission.

Next, the Cross-Petitioners claim that the original settlement discussions provided for a stipulated judgment in the amount of $10 million. Again this "fact" is supported only by the inadmissible hearsay contained in a declaration of the Cross-Petitioners' own counsel.

The statement of facts contained in the Brief in Opposition, pp. 4-5, contains a long recitation of the alleged conversations between counsel for the Cross-Petitioners and counsel for the Cross-Respondent regarding the Cross-Petitioners' fears that the Cross-Respondent would breach the agreement, the reasons for the Cross-Petitioners continuation of the foreclosure sale of the Rowan Building and a history of the negotiations that led to the entry of the Stipulated Judgment. The only source for any of these alleged "facts" is, once again, the inadmissible hearsay in the declaration of counsel for the Cross-Petitioners.

The Cross-Petitioners frequently point to the fact that the Cross-Respondent testified at the hearing on the entry of the Stipulated Judgment that he was not threatened or

under any duress to enter into the Stipulated Judgment. The "hearing" however consisted only of a presentation of the Stipulated Judgment to the Superior Court Judge and the examination of Mr. Aslan by counsel for the Cross-Petitioners. The reality is that the Cross-Petitioners would not have entered into the Stipulated Judgment had Mr. Aslan testified that he was entering it under duress. His testimony in such circumstances cannot be held to reflect his true state of mind when entering into the Stipulated Judgment. In fact, the Cross-Respondent has consistently argued that he was under extreme financial pressure to resolve his disputes with the Banks as a result of their filing of lis pendens against all of his real estate holdings and the pending foreclosure of the Rowan Building.

Next, the Brief in Opposition recites as "fact" alleged conversations between the Cross-Respondent and his former counsel, Charles Rose, regarding Rose's interpretation of the Letter Agreement as providing for a forfeit of the Rowan Building proceeds if the Cross-Respondent attacked the Stipulated Judgment. This inadmissible hearsay and privileged information is derived from a declaration signed by Rose in support of the Cross-Petitioners' filings below after the Cross-Respondent brought a malpractice lawsuit against Rose. Once again, this kind of statement is not a "fact," but merely an allegation made by the Cross-Petitioners that is disputed by the Cross-Respondent.

The Cross-Petitioners contend that the Cross-Respondent's statement regarding the reason the Amana Corporation's offer to purchase the Stipulated Judgment was not consummated is incorrect. Although the reason for the failure of the parties to reach an agreement is not essential or relevant to the present question, the Cross-Respondent points out, once again, that the only support for the Cross-Petitioners' assertion is the declaration of its own counsel—inadmissible hearsay.

In conclusion, the Cross-Respondent and the Cross-

Petitioners have a marked disagreement about the circumstances which led to the Cross-Petitioners' claim in the Cross-Respondent's bankruptcy case. What is not at issue is that the claim is based on the provisions of the Stipulated Judgment and the Letter Agreement. The question before the bankruptcy court was, in essence, whether and in what amount should the Cross-Petitioners' claim be allowed.

D. Procedural Background.

The procedural background of the case has been thoroughly covered in both the Petition, the Brief in Opposition and the Cross-Petition. The Cross-Respondent accepts the correction made in the Brief in Opposition regarding whether the Cross-Petitioner requested a rehearing on the May 29, 1992, opinion issued by the Ninth Circuit Court of Appeals. The record indicates that the Cross-Petitioners did not request a rehearing en banc as was erroneously stated in the Petition.

ARGUMENT

A. Summary of Argument.

Due process requires that no person may be deprived of a property interest without notice and an opportunity for a meaningful hearing. The three factors set forth in *Mathews v. Eldridge*, 424 U.S. 319, 96 S.Ct. 893, 47 L.Ed. 2d 18 (1976) must be weighed and balanced to identify the kind of notice and type of hearing dictated by the due process clause.

The Cross-Petitioners arguably have no property interest at all in the Rowan Building proceeds, but assuming that they do, they have already had the opportunity for a judicial hearing on the merits of each argument raised in the Cross-Petition. There is no reason to reconsider the setoff issue underlying the Cross-Petition in the event the Petition is granted.

B. The Cross-Petitioners Have Received Due Process of Law.

The due process clause of the Fifth Amendment provides that "[n]o person shall . . . be deprived of life, liberty, or property, without due process of law." U.S. Const., Amend. V.[2] Procedural due process requires at a minimum

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[2]The Cross-Respondent can find no authority for the basic premise upon which the Cross-Petition relies; that the Cross-Petitioners, banking corporations which are wholly-owned subsidiaries of foreign corporations, and "persons" within the meaning of the Fifth Amendment. The Petitioner concedes that "[i]t is well established that a corporation is a 'person' within the meaning of the Fourteenth Amendment," *Metropolitan Life Incs. Co. v. Ward*, 470 U.S. 869, 881 n. 9, 105 S.Ct. 1676, 1683 n. 9, 84 L.Ed.2d 751 (1985), and that alien individuals are protected by the due process clause of the Fifth Amendment, *Mathews v. Diaz*, 426 U.S. 67, 96 S.Ct. 1883, 48 L.Ed. 2d 478 (1976). Chief Justice Rehnquist propounded the rationale for extending the Fourteenth Amendment's protection to a corporation's property rights in *First National Bank of Boston v. Bellotti*, 435 U.S. 765, 823-24, 98 S.Ct. 1407, 55 L.Ed. 2d 707 (1978) (Rehnquist, J. dissenting). Since the states character corporations and allow them to acquire and utilize property under state law, it follows that the states may not deprive a corporation of that property without due process of law. *Id.* "The word 'person,' however, is not a term of art with a fixed meaning whenever it is used." *Pfizer, Inc. v. Gov't of India*, 434 U.S. 308, 316, 98 S.Ct. 584, 589, 54 L.Ed. 2d 563 (1978). To interpret the meaning of the work "person" in a statute, this Court has first examined the statute's language and purpose and, if no clue to its

that "deprivation of life, liberty or property by adjudication be preceded by notice and opportunity for hearing appropriate to the nature of the case." *State v. Central State Bank & Trust Co.*, 339 U.S. 306, 313, 70 S.Ct. 652, 94 L.Ed. 865 (1950). The opportunity for hearing "must be granted at a meaningful time and in a meaningful manner." *State v. Manzo*, 380 U.S. 545, 552, 85 S.Ct. 1187, 14 L.Ed. 2d 62 (1965).

The Cross-Petition does not discuss the notice requirement, but appears to focus on whether the Cross-Petitioners

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meaning is discovered there, has sought the "indicia of congressional intent at the time the statute was enacted." *Ngiraingas v. Sanchez*, 495 U.S. 182, _____, 110 S.Ct. 1737, 1740, 109 L.Ed. 2d 163 (1990). Applying that method to the Bill of Rights, one notes that a corporation has no "life or liberty" interests, the two other interests protected by the due process clause. Thus the language of the Fifth Amendment does not appear on its fact to include corporate entities. The intent of the framers must be considered next. The Fifth Amendment is directed primarily to the protection of individuals and personal rights, *U.S. v. White*, 322 U.S. 694, 698, 64 S.Ct. 1248, 88 L.Ed. 2d 1542 (1944), and that is what was intended at the time the Fifth Amendment was ratified. If the Respondents are not among the "persons" protected by the due process clause of the Fifth Amendment, then they lack standing to bring the Cross-Petition and it should be denied on those grounds. *See, e.g., State of Alabama v. U.S. E.P.A.*, 871 F.2d 1548, 1554 (11th Cir. 1989), *cert. denied*, 493 U.S. 991, 110 S.Ct. 538, 107 L.E. 2d 535 (1989) (state was not among entities protected by due process clause of Fifth Amendment and lacks standing to claim that E.P.A. was compelled to provide it with notice and opportunity to be heard).

received an opportunity for hearing, and whether the opportunity for hearing was granted at a meaningful time and in a meaningful manner. Thus, the Cross-Petition asserts that the Cross-Petitioners are entitled to an evidentiary hearing on the issue of whether the Rowan Building resale proceeds should have been credited against the Cross-Petitioners' claim in the Cross-Respondent's bankruptcy case. The Cross-Petitioners argue that due process requires that they be afforded an evidentiary hearing in the event the Petition is granted and this Court either finds for the Cross-Respondent on the merits or remands the Cross-Respondent's case to the bankruptcy court for a factual determination of the penalty issue.

1. Identification of the Specific Dictates of Due Process Requires a Consideration of the Three Factors Enunciated in *Mathews*.

This Court has identified three distinct factors which must be considered in identifying the specific dictates of due process in any given scenario. Those factors are:

> First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.

Mathews v. Eldridge, 424 U.S. 319, 335, 96 S.Ct. 893, 903, 47 L.Ed. 2d 18 (1976). These factors must be weighed and balanced to determine the kind of notice and type of hearing required to meet the mandate of the due process clause. *See, e.g., Orloff v. Cleland*, 708 F.2d 372 (9th Cir. 1983).

2. Application of the *Mathews* Test to the Case at Bar Shows That the Cross-Petitioners Have Received Due Process of Law.

The first factor to be considered under the three-part test set forth in *Mathews* is the private interest that will be affected by official action. Here, the very heart of the dispute is whether the Cross-Petitioners have any property interest in the proceeds from the resale of the Rowan Building. The $3.1 million credit has been remitted to the Cross-Respondent under the terms of the Stipulated Judgment and the Letter Agreement. The Cross-Petitioners claim that they should be excused from honoring this provision of the agreement, even though they have received the full amount of the Stipulated Judgment. The Cross-Respondent argues that the Cross-Petitioners have no property interest in the disputed sum, and thus no property interest to be protected under the due process clause.

The second factor to be considered is whether there is a risk of erroneous deprivation of any property interest through the procedure used. The risk appears to be quite small. Not only has the issue been extensively litigated in the bankruptcy court and the appellate courts with findings in favor of the Cross-Respondent at all levels, but the Cross-Respondent asserts that the disputed sum is not the property of the Cross-Petitioners.

The Cross-Petitioners appear to rely on two possible arguments to support their position that the Rowan Building proceeds should not have been credited against the claim. First, they argue that the Letter Agreement contained an implied covenant not to attack the Stipulated Judgment. This argument was considered by the Ninth Circuit Court of Appeals and rejected. The Ninth Circuit held that good faith lawsuits were always allowed and further found that any covenant not to sue would have applied to the merits of the original suit, not to the merits of the settlement of that

suit. *See* Pet., App. B-7, *citing Winchester Drive-In Theatre, Inc. v. Warner Bros. Pictures Dist. Corp.*, 358 F.2d 432 (2d Cir. 1966).

Second, the Cross-Petitioners claim they were excused from their performance under the contract when the Cross-Respondent breached the Letter Agreement and/or the Stipulated Judgment. Once again, this issue was considered by the Ninth Circuit Court and found to be without merit. Pet., App. B-7. The Cross-Petitioners have been paid the full amount owed to them under the agreement, thereby receiving the full benefit of the bargain.

If the Cross-Respondent is successful in having the claim reduced by the amount of the $2 million penalty, the Cross-Petitioners argue that this successful attack on the Stipulated Judgment would constitute a breach and thus vitiate their performance. This argument ignores the fact that the Cross-Respondent has *already* attacked the Stipulated Judgment, regardless of whether that attack is ultimately successful. This fact existed at every stage of the proceedings below and none of the lower courts found that it constituted a breach of the agreement. There is no need to consider the same argument again.

Due process requires,

> at a minimum, that absent a countervailing state interest of overriding significance, persons forced to settle their claims of right and duty through the judicial process must be given a meaningful opportunity to be heard.
>
> Due process does not, of course, require that the defendant in every civil case actually have a hearing on the merits. . . . What the Constitution does require is "an *opportunity* . . . granted at a meaningful time and in a meaningful manner," [citing *State v. Manzo*, 380 U.S. at 552 (emphasis added)], "for [a] hearing appropriate to the nature of the case,"

> [citing *State v. Central State Bank & Trust Co.*, 339 U.S. at 313]. The formality and procedural requirements for the hearing can vary, depending upon the importance of the interests involved and the nature of the subsequent proceedings. [Footnote omitted.]

Boddie v. Connecticut, 401 U.S. 371, 377-78, 91 S.Ct. 780, 28 L.Ed. 2d 113 (1971).

Where this Court has established a due process right to an evidentiary hearing, the person at risk of being deprived of a property interest has had a far more important interest to protect than the alleged property interest of the Cross-Petitioners. For example, welfare recipients were held to be entitled to an evidentiary hearing prior to the termination of their benefits in *Goldberg v. Kelly*, 397 U.S. 254, 266-71, 90 S.Ct. 1011, 1019-22, 25 L.Ed. 2d 287 (1970), and suits for pre-judgment replevin of property were held to require more than a mere ex parte proceeding before a court clerk in *Fuentes v. Shevin*, 407 U.S. 67, 96-97, 92 S.Ct. 1983, 2002-03, 32 L.Ed. 2d 556 (1972).

In the case at bar, the Cross-Petitioners have already been granted a hearing on each argument they now raise. The Cross-Respondent contends that none of the Cross-Petitioners' arguments require any additional factual determination to be resolved. An evidentiary hearing is not necessary to decide the issues of law raised by the Cross-Petitioners.

The third factor that must be considered under the *Mathews* test is the government's interest. The government's interest here is in the prompt resolution of disputes in the courts and in judicial economy. This interest in bringing final resolution of the issues is significant and outweighs the minimal risk to the Cross-Petitioners that they will be deprived of a property interest without due process of law.

C. The Issue Raised in the Petition Is Not Tied to the Issue Raised in the Cross-Petition.

The Petition seeks a writ of certiorari to the Ninth Circuit Court of Appeals because the Cross-Respondent was never granted an opportunity to be heard regarding whether the Cross-Petitioners' claim included an invalid penalty. The Cross-Respondent has argued that the bankruptcy court misapplied the doctrine of res judicata in the context of the claims allowance process.

The Cross-Petition seeks a writ of certiorari only in the event the Cross-Respondent is successful on the merits. The Cross-Petitioners claim that if the penalty portion of the claim is held to be invalid, then that would entitle them to a reconsideration of the merits of their contract interpretation argument.

The only relationship between the Petition and the Cross-Petition is that both arise out of the same set of circumstances and both involve a dispute over the allowed amount of the claim. The claims allowance process requires the bankruptcy court to consider whether a claim should be allowed against the estate and, if so, in what amount it should be allowed. Both the Petition and the Cross-Petition deal with the amount question. Other than this surface similarity, however, there is no relationship between the two. The Cross-Respondent's penalty issue does not require any new consideration of the setoff of the Rowan Building proceeds.

Even if the Cross-Petitioners' claim is ultimately lowered in the amount of the illegal penalty, there is nothing in the Stipulated Judgment or Letter Agreement which would indicate that the Rowan Building proceeds should not be credited. The documents on their face provide that the proceeds will be credited to the Cross-Respondent when the Stipulated Judgment amount is paid in full. The courts below have unanimously agreed that the

contract has been correctly interpreted, that the Cross-Respondent has performed, and that the $3.1 credit was properly applied.

D. The Cross-Petitioners' Reliance on Supreme Court Rule 10.1(a) Is Misplaced.

The Cross-Petitioners rely on Supreme Court Rule 10.1(a) as their reason for this Court to grant the Cross-Petition. Rule 10.1(a), however, states that "[w]hen a United States court of appeals . . . has so far departed from the accepted and usual course of judicial proceedings, or sanctioned such a departure by a lower court, as to call for an exercise of this Court's power of supervision," then this Court will consider granting a petition for a writ of certiorari. S.Ct.R. 10.1(a). The Cross-Petitioners do not point to any departure from the accepted course of judicial proceedings by the Ninth Circuit Court of Appeals or any lower court. Instead, the Cross-Petitioners seem to argue that *this* Court will have departed from the accepted and usual course of judicial proceedings if it fails to grant the Cross-Petition under certain conditions. This cannot be a reason for granting a writ of certiorari to the Ninth Circuit Court of Appeals.

CONCLUSION

The Cross-Petition for Writ of Certiorari should be denied, regardless of the disposition of the Petition. The Cross-Petitioners have not been deprived of due process of law under the Fifth Amendment. They have no property interest to be protected, but assuming they have a colorable claim to the Rowan Building proceeds, they have already been granted notice and a meaningful hearing in the lower court on each and every argument made in the Cross-Petition.

Respectfully submitted,

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Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

REPLY BRIEF OF THE HONGKONG AND SHANGHAI BANKING CORPORATION AND CENTRAL BANK IN SUPPORT OF CROSS-PETITION FOR WRIT OF CERTIORARI

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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1992

In re MOSES N. ASLAN,
Debtor.

THE HONGKONG AND SHANGHAI BANKING CORPORATION AND CENTRAL BANK,
Petitioners,

VS.

MOSES N. ASLAN,
Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

REPLY BRIEF OF THE HONGKONG AND SHANGHAI BANKING CORPORATION AND CENTRAL BANK IN SUPPORT OF CROSS-PETITION FOR WRIT OF CERTIORARI

INTRODUCTION

In their Cross-Petition for Writ of Certiorari (the "Cross-Petition"), The Hongkong and Shanghai Banking Corporation ("Hongkong Bank") and Central Bank (sometimes collectively "the Banks") argued that if (and only if) the certiorari petition of Moses N. Aslan ("Aslan") were granted, *then* due process would

require that the Banks be afforded a hearing on whether Aslan, if he is excused from paying $2,000,000 of the Banks' judgment amount, is still entitled to a contractual credit against the judgment amount.

In his Brief in Opposition,[1] Aslan makes four specious arguments:

1. Aslan argues that the only evidence before the lower courts that his indebtedness to the Banks resulted from a check kite was inadmissible hearsay. Aslan's argument is unavailing, because (a) no objection was made to the evidence in question; and (b) all the evidence Aslan now challenges constituted *his own admissions*, which obviously were not hearsay at all. Moreover, even if, contrary to *all* the evidence, Aslan somehow could establish that he took the Banks' millions with their consent, the Banks' claims have been reduced to a final judgment, making the basis for the claims irrelevant to Aslan's arguments.

2. Aslan urges that Hongkong Bank, a foreign corporation, and Central Bank, the subsidiary of a foreign bank, are not entitled to due process of law and, therefore, cannot have the hearing they request. That argument contravenes all applicable authority. Foreign corporations may not have their valuable assets confiscated without due process.

3. Aslan asserts that due process for the Banks would not require, in any event, an evidentiary hearing. Again, Aslan's argument contravenes the authorities. Property rights cannot be taken without a meaningful opportunity to be heard.

4. Finally, Aslan asserts that Rule 10.1 of the Rules of this Court does not apply because the Court of Appeals did not depart from the usual course of judicial proceedings. Under Rule 10.1, this Court plainly has the power to review the entire case, such that *if* Aslan's Petition is granted, *then* the Banks' Cross-Petition

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[1]Aslan has filed a brief in opposition to the Banks' Cross-Petition, but no reply brief on his own Petition for Writ of Certiorari. Accordingly, this Reply Brief by the Banks addresses only those new issues raised in Aslan's Brief in Opposition.

may be considered, in order to *prevent* a departure from the usual course of proceedings and a miscarriage of justice.

ARGUMENT

1. There Is Overwhelming Evidence Of The Check Kite.

Aslan first argues that all the evidence that he incurred his $8.3 million debt to the Banks through a check kite was inadmissible hearsay.

Even if his argument were correct, it would not affect the Banks' rights under the final Judgment, or under the Letter Agreement which gave Aslan a credit against the Judgment conditioned on his full performance and ratification of the Judgment. However, all the evidence cited by the Banks was admissible in any event.

The evidence attacked by Aslan consisted of declarations (a) by persons to whom Aslan admitted the check kite, and (b) by Aslan's former counsel, Charles T. Rose ("Rose"). However, the declarations recited *admissions* made by Aslan, which are not hearsay but fall within a well settled exception to the hearsay rule. Fed. R. Evid. 801(d)(2). Moreover, Rose's statements were not protected by the attorney-client privilege, because Aslan had already commenced a malpractice action against Rose. [Aslan's Opposition Brief, at p. 6; Cal. Evid. Code § 958.] Further, Aslan has waived any evidentiary objections by failing to make them below.

Finally, Aslan has not offered in this Court, nor did he offer in the courts below, any alternative explanation of how he incurred his indebtedness to the Banks. It was, purely and simply, a check kite.

2. Foreign-Owned Corporations Are Entitled To Due Process.

In his Brief in Opposition, Aslan asserts that he "can find no authority for the basic premise upon which the Cross-Petition relies; that the Cross-Petitioners, banking corporations which are wholly-owned subsidiaries of foreign corporations, and [*sic*] 'persons' within the meaning of the Fifth Amendment." Aslan con-

cedes, however, that "[i]t is well established that a corporation is a 'person' within the meaning of the Fourteenth Amendment,' *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, 881 n.9, 105 S.Ct. 1676, 1683 n.9, 84 L.Ed. 2d 751 (1985), and that alien individuals are protected by the due process clause of the Fifth Amendment, *Mathews v. Diaz*, 426 U.S. 67, 96 S.Ct. 1883, 48 L.Ed. 2d 478 (1976)." Oppos. Brief at 8 n.2. The principles conceded by Aslan defeat his argument that the Banks have no due process rights.

In *United States v. Verdugo-Urquidez*, 494 U.S. 1092, 110 S.Ct. 1056, 1064, 108 L.Ed. 2d 1968 (1990), this Court observed that a series of United States Supreme Court decisions has held that aliens enjoy certain constitutional rights. Among other things, resident aliens are "persons" within the meaning of the Fifth Amendment. *Id.* at 1064; *Kwong Hai Chew v. Colding*, 344 U.S. 590, 596, 73 S.Ct. 472, 97 L.Ed. 576 (1953). Therefore, even if the Banks were considered resident aliens because of their foreign connections, that would not derogate from their status as persons within the meaning of the Fifth Amendment.

In Russian Volunteer Fleet v. United States, 282 U.S. 481, 491, 51 S.Ct. 229, 75 L.Ed. 2d 473 (1931), the Supreme Court held that a corporation organized under the laws of Russia was an alien friend, entitled to the Fifth Amendment due process protections against the taking of property.

> "As alien friends are embraced within the terms of the Fifth Amendment, it cannot be said that their property is subject to confiscation here because the property of our citizens may be confiscated in the alien's country. The provision that private property shall not be taken for public use without just compensation establishes a standard for our government which the Constitution does not make dependent upon the standards of other governments." 282 U.S. at 491-492.

Thus, "[e]ven non-resident aliens are entitled to the protection of the Fifth Amendment's prohibition on unlawful takings." *Alvarez-Mendez v. Stock*, 746 F.Supp. 1006, 1015 (C.D. Cal. 1990), *aff'd*, 941 F.2d 956 (9th Cir. 1991).

Under all these authorities, it is manifest that the Banks are entitled to the due process protections of the Fifth Amendment.

3. Due Process Requires That If Aslan Succeeds In Reducing The Amount Of The Banks' Judgment, The Banks Then Are Entitled To An Evidentiary Hearing On Whether Consideration For The Rowan Building Credit Has Failed.

In his Opposition, Aslan argues that because the lower courts considered the parties' rights with regard to the Rowan Building credit under the Letter Agreement at the time Aslan's "penalty" argument was before the courts, therefore the Banks have already had the only hearing to which they are entitled.

Aslan ignores both the applicable case law on the subject of what constitutes a hearing that comports with due process requirements, and also the fact that the Banks' Cross-Petition is expressly linked to Aslan's Petition.

The Banks' argument, to the effect that if Aslan successfully attacks the Judgment, consideration for the Letter Agreement has failed and the Banks need not give him the Rowan Building credit hereunder, has not been the subject of an evidentiary hearing, for the simple reason that Aslan's attacks on the Judgment have been rejected at every stage. The lower courts have held in effect that because the Banks are receiving the entire amount of the Judgment and Aslan's attacks on the Judgment have been rejected, the Banks have nothing to complain about.

That may change if Aslan obtains a favorable result in this Court, or upon remand from this Court. No hearing has been held on whether, if Aslan succeeds in reducing the Judgment, he then has forfeited any benefits under the Letter Agreement. The Banks seek a hearing on that limited question, if and only if Aslan's Petition is granted.

4. The Banks Are Entitled To A Meaningful Hearing.

In *Mathews v. Eldridge*, 424 U.S. 319, 333, 96 S.Ct. 893, 47 L.Ed. 2d 18 (1976), this Court stated:

> "This Court consistently has held that some form of hearing is required before an individual is finally deprived of a property interest. The 'right to be heard before being condemned to suffer grievous loss of any kind, even though it may not involve the stigma and hardships of a criminal conviction, is a principle basic to our society.' The fundamental requirement of due process is the opportunity to be heard 'at a meaningful time and in a meaningful manner.' " [Citations omitted.]

Further, the court in *Mathews*, quoting *Morrissey v. Brewer*, 408 U.S. 471, 481, 92 S.Ct. 2593, 33 L.Ed.2d 484 (1972), stated: "[D]ue process is flexible and calls for such procedural protections as the particular situation demands." The Court listed three factors relevant to determining if official action comports with due process rights: (1) the private interest affected; (2) the risk of an erroneous deprivation of that interest through the procedures used and the probable value of additional or substitute safeguards; (3) and the government's interest. 424 U.S. at 335. *Accord, Little v. Streater*, 452 U.S. 1, 6, 101 S.Ct. 202, 68 L.Ed.2d 627 (1981).

In *Orloff v. Cleland*, 708 F.2d 372, 379 (9th Cir. 1983), the Court of Appeals observed that under *Mathews*: "The central meaning of procedural process is that parties whose rights are to be affected are entitled to be heard at a meaningful time and in a meaningful manner." Similarly, in *Propert v. District of Columbia*, 948 F.2d 1327 (D.C. Cir. 1991), the Court stated "The constitutional requirement of some kind of hearing means, at a minimum, that the affected individual must have a meaningful opportunity to present his case before a neutral decision maker." *Id.* at 1333.

Under these standards, it is clear that if Aslan obtains a $2,000,000 advantage, in contravention of the Letter Agreement in which he agreed to pay the entire Judgment amount, then the Banks should receive a hearing.

First: The private interest affected is the right to more than $3.1 million plus interest, not a trivial sum.

Second: Because there has been no evidentiary hearing on the question, there is a serious risk that the Banks will be deprived of their rights if Aslan prevails on his "penalty" argument. Indeed, as the Banks have explained in their Cross-Petition, the lower courts held that the Banks had obtained all the benefits of the Judgment, and therefore Aslan was entitled to retain the consideration that had passed to him under the Letter Agreement. If Aslan succeeds in depriving the Banks of the benefit of the Letter Agreement, then it seems likely that, upon remand, the lower courts would examine, and change their position on, whether the Banks had obtained the consideration for which they had bargained in exchange for giving Aslan the conditional Rowan Building credit.

Third: If Aslan's Petition is granted, reviewing the entire case, either in this Court or on remand, will not result in a cognizably greater burden on the Court system than if Aslan's arguments were reconsidered in isolation.

Under these circumstances, there is no justification for allowing Aslan a $2,000,000 reduction of the Judgment, without at the same time giving the Banks a full and fair opportunity to argue that such a result deprives Aslan of any right to further savings under the Letter Agreement.

5. This Court May Grant The Cross-Petition.

Aslan argues that the Cross-Petition must be denied because Rule 10.1(a) only provides for certiorari where a "court of appeals . . . has . . . departed from the accepted and usual course of judicial proceedings". Here, Aslan's argument goes, any such departure would be by this Court, or by the lower courts after remand.

Aslan's argument is entirely unavailing.

First, Rule 10.1 by its own language is "neither controlling nor fully measuring the Court's discretion" to grant a writ of certiorari. Indeed, the Cross-Petition cites (at p. 6, n. 2) authority for

the proposition that the Court may review the Banks' claims *sua sponte*. Further, "[a] petition for writ of certiorari can expose the entire case to review." *Christianson v. Colt Industries Operating Corp.*, 486 U.S. 800, 817, 108 S.Ct. 2166, 100 L.Ed.2d 811 (1988).

Second, and in any event, the Banks contend that if Aslan prevailed on his argument but the Banks were foreclosed from making theirs, that result would be a radical departure "from the accepted and usual course of judicial proceedings."

In short, if Aslan's petition is granted and receives favorable action, this Court's power also to review the Banks' claims is not restricted.

6. Conclusion.

Aslan's Opposition fails to recognize that the Banks seek relief only if, and to the extent that, Aslan obtains a favorable disposition on his Petition. Equity and due process require that if Aslan prevails on his claims, and the Judgment amount is reduced, the Banks at least receive a hearing on whether they still must give Aslan the benefit of a Letter Agreement, the consideration for which was ratification and payment of the *entire* Judgment.

For all the reasons stated herein and in the Cross-Petition, the Banks respectfully submit that Aslan's Petition should be denied; but that if Aslan's Petition is granted, this Cross-Petition also should be granted so that the entire case may be remanded for any appropriate proceeding in the Bankruptcy Court.

Respectfully submitted,

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